

BUDGET OVERVIEW FOR FISCAL YEAR 1990

HEARINGS **BEFORE THE** **COMMITTEE ON APPROPRIATIONS** **UNITED STATES SENATE** **ONE HUNDRED FIRST CONGRESS** **FIRST SESSION**

SPECIAL BUDGET HEARINGS
CONGRESSIONAL BUDGET OFFICE
DEPARTMENT OF THE TREASURY
OFFICE OF MANAGEMENT AND BUDGET

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BUDGET OVERVIEW FOR FISCAL YEAR 1990

TUESDAY, FEBRUARY 28, 1989

U.S. SENATE,
COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The committee met at 11 a.m., in room SD-192, Dirksen Senate Office Building, Hon. Robert C. Byrd (chairman) presiding.

Present: Senators Byrd, Inouye, Johnston, Burdick, Leahy, DeConcini, Bumpers, Lautenberg, Harkin, Reid, Adams, Kerrey, Hatfield, Stevens, McClure, D'Amato, Specter, Domenici, Grassley, Nickles, and Gramm.

OFFICE OF MANAGEMENT AND BUDGET

STATEMENT OF RICHARD G. DARMAN, DIRECTOR

OPENING STATEMENT OF CHAIRMAN BYRD

The CHAIRMAN. The hour of 11 o'clock having arrived, this committee starts on time. This hearing is the first of three full committee hearings on the fiscal year 1990 Budget of President Bush. Our witness today is Mr. Richard G. Darman, the Director of the Office of Management and Budget. President Bush in his State of the Union Address called upon Congress to work with his administration in producing a budget on time.

I am certain that all members of the committee share my interest in doing that. It is in everyone's best interest that we pass the 13 appropriation bills on time. The President also spoke about the need to increase spending in numerous areas. He cited specific proposals such as \$2.2 billion for the National Science Foundation; \$2.4 billion over the current year for NASA; the beginning of a \$500 million program to reward America's best schools, merit schools; \$1.6 billion for AIDS research and prevention; and a \$1.1 billion increase for drug abuse programs.

RESIDUAL FREEZE CATEGORY

But the President did not provide any information on literally hundreds of other programs. Instead, he chose to lump those into a category called nondefense, mostly discretionary spending, and suggested that they be frozen in the aggregate at their fiscal year 1989 outlay level of \$136 billion.

He did not tell Congress or the American people where the budget has to be cut to achieve his \$136 billion freeze. It makes one wonder if the administration is leading us into the age of Joe Isuzu

Federal budgeting. Now that is why I wrote the President on February 14, along with Senator Sasser, the chairman of the Budget Committee, to state that under the Budget and Accounting Act of 1921 the President shall—talking about the act now—the President shall submit to the Congress a statement of budget authority, proposed budget authority, budget outlays, and proposed budget outlays, and descriptive information in terms of (a) a detailed structure of national needs that refers to the missions and programs of agencies as defined in section 101 of this title; and (b) the missions and basic programs.

President Reagan complied with this requirement on January 9, 1989. President Bush has not provided anything yet other than suggestions, options, and residual options. President Reagan's budget cannot be amended by those informal methods. President Bush's proposals must be formally submitted as budget amendments to the Speaker of the House and the President of the Senate.

I understand that he intends to submit amendments for his priorities. Those are the increases that we heard about in the State of the Union Address, and in connection with which I applauded him quite enthusiastically. But he will not do so for the \$136 billion, and what is called nondefense, mostly discretionary spending.

For any programs for which Bush budget amendments are not received, Congress has no alternative but to treat President Reagan's request as President Bush's request. The administration talks about the need for early negotiations. There is nothing wrong with negotiations. But this confusion, whether intended or not, caused by not knowing where the President stands on hundreds of appropriation accounts is heading us all toward a train wreck.

Unless the administration fills in the blanks, I am concerned that we will be facing a massive, continuing resolution this fall. I don't want that. The President does not want it. I am sure that no member of this committee wants it.

EXCERPTS FROM MEMORANDUM

I was pleased to receive from you, Mr. Darman, a memorandum dated February 16, to executive branch officials providing them with guidance on the President's budget plan. In that memo, you point out that the President's budget plan contains a residual freeze category where program detail is not presented in the document entitled "Building a Better America."

Regarding that residual freeze category, your memo reads in part:

The Reagan budget proposals for items within the residual category are to be treated as if they were the Bush administration proposals for purposes of starting the budget process with the Congress. The alternative of starting with a nominal freeze on each and every account is an analytical possibility, but it is less practical at this stage than starting with the Reagan marks.

Now I think that rather than read extracts from that directive, I would prefer to read the entire directive. Where is that directive? Let us read it all. This is a memorandum for heads of departments and agencies dated February 16 from Richard G. Darman. Subject: Guidance to executive branch officials on the President's budget plan:

The purpose of this memorandum is to provide you with guidance in preparing testimony and commenting publicly on the President's 1990 budget plan presented to Congress February 9. Although the situation varies by agency, most of the budget is available in detail in the book entitled "Building a Better America."

Now that is not accurate. Most of the budget is not available in detail in the book. Anybody can look at this book and see that is not quite an accurate statement. Here is the budget in my hand. This is the budget. It has hundreds and hundreds of line items in it. That is what we have to work with.

This book "Building a Better America," does not have the hundreds and hundreds and hundreds of line items that this committee has to work with. So the statement that "Most of the budgeting is available in detail in the book entitled 'Building a Better America,'" I submit is inaccurate.

Going ahead with the reading of the memo:

The initiatives, reforms, natural declines, and special obligations discussed in the book are straightforward as is their rationale. They should be presented and defended directly. The President's budget plan does, however, contain a residual nominal freeze category where program detail is not presented in the book. This category is frozen in the aggregate at the 1989 dollar level for outlays.

Each agency should first calculate which portions of its 1990 budget are in the residual freeze category. This can readily be done by first identifying those items in the agency book that are explicitly described in the book. The remainder of the agency budget is in the residual category.

Items in this residual freeze category as indeed the entire budget are subject to negotiations with Congress. The negotiations may lead to decisions and detail or quite possibly broad caps on various categories of spending. As discussed in the Cabinet meeting and pending the outcome of the negotiations, the Reagan budget proposal—this is key—the Reagan budget proposals for items within the residual category are to be treated as if they were the Bush administration proposals for purposes of starting the budget process with the Congress.

The alternative of starting with a nominal freeze on each and every account is analytical possibility, but it is less practical at this stage than starting with the Reagan marks. However, any agency may propose to OMB a different mix of budget authority and outlays within its portion of the residual freeze category providing the outlay total is not changed.

If such an alternative mix is approved, it may be presented to the Congress. The President has identified his priorities about which we would expect to be firm. But in the residual freeze area, the intention is to be flexible. With respect to the residual freeze category, therefore, it is our clear expectation that there will be many cases in which an alternative mix will be judged desirable and/or necessary.

The remainder of the memorandum will be inserted in the record in its entirety.

[The information follows:]

Please ensure that all appropriation and budget justification materials continue to be submitted to this office for review, as required by OMB Circular No. A-11—Preparation and Submission of Annual Budget Estimates. Similarly, agency draft bills, testimony, and reports to Congress on authorizing and other substantive legislation should be submitted in accordance with OMB Circular No. A-19—Legislative Coordination and Clearance. In cases where necessary authorizing or substantive legislation has not yet been submitted to OMB, we ask that you please do so as soon as possible.

If you have questions concerning this memorandum, please have appropriate staff contact the budget examiner for your agency.

Thank you.

REFERENCE TO REAGAN BUDGET

The CHAIRMAN. So if I understand that directive correctly, it does represent some progress. It does represent some progress in

getting the specifics of this budget because it says that where the blanks are not filled in, your agency heads, in appearing before the congressional committees, are to use the Reagan marks.

Now we do have those Reagan marks. They are in this book, The Budget of the United States Government. They are in there. So if you do not have what Mr. Bush says, then you are to use the Reagan marks. So we are making some progress.

For quite awhile it was difficult to get that understanding. I want to thank you, Mr. Darman, for your responsiveness to my request for detailed line item information. What Mr. Sasser and I were doing in writing to the President, we were saying to the President where those items are not shown, we have no alternative, Mr. President, but to use Mr. Reagan's marks as yours.

So even now we are not able to fill in the blanks except by using the Reagan marks, and Mr. Darman in his memorandum to agency heads made that clear that that was to be the approach taken. We received information as late as yesterday, and it has been helpful. That information came from Mr. Darman. So we are making progress. I want to encourage you to continue to work with us on the difficult challenges that lie ahead.

You will find Congress more than willing to meet the administration halfway if the administration will just level with us and the American people. For now, that constitutes my opening statement.

[The statement follows:]

STATEMENT OF ROBERT C. BYRD

This hearing is the first of three Full Committee hearings on the Fiscal Year 1990 budget of President Bush. Our witness today is Mr. Richard G. Darman, the Director of the Office of Management and Budget.

President Bush, in his State of the Union Address, called upon Congress to work with his Administration in producing a budget on time. I am certain that all Members of the Committee share my interest in doing that. It is in everyone's best interest that we pass the 13 Appropriation Bills on time.

The President also spoke about the need to increase spending in numerous areas. He cited specific proposals such as \$2.2 billion for the National Science Foundation; \$2.4 billion over the current year for NASA; the beginning of a \$500 million program to reward America's best schools--"merit schools"; \$1.6 billion for AIDS research and prevention; and a \$1.1 billion increase for Drug Abuse programs.

But, the President did not provide any information on literally hundreds of other programs. Instead, he chose to lump those into a category called "Nondefense (Mostly) Discretionary" spending and suggested that they be frozen, in the aggregate, at their FY 1989 outlay level of \$136 billion. He did not tell Congress or the American people where the budget has to be cut to achieve his \$136 billion freeze. It makes me wonder if the Administration is leading us into the Age of Joe Isuzu Federal Budgeting.

That is why I wrote to the President on February 14th to state

that under the Budget and Accounting Act of 1921, the President shall submit to the Congress:

"a statement of budget authority, proposed budget authority, budget outlays, and proposed budget outlays, and descriptive information in terms of--

(A) a detailed structure of national needs that refers to the missions and programs of agencies (as defined in section 101 of this title); and

(B) the missions and basic programs."

President Reagan complied with this requirement on January 9, 1989. President Bush has not provided anything yet, other than suggestions, options, and residual options. President Reagan's budget cannot be amended by these informal methods. President Bush's proposals must be formally submitted as budget amendments to the Speaker of the House and the President of the Senate. I understand he intends to submit amendments for his priorities--mostly increases in the budget--but will not do so for \$136 billion in what is called "Nondefense (Mostly) Discretionary" spending. For any programs for which Bush budget amendments are not received, Congress has no alternative but to treat President Reagan's requests as President Bush's.

The Administration talks about the need for early negotiations. There is nothing wrong with negotiations. But this confusion, whether intended or not, caused by not knowing where the President stands on hundreds of appropriation accounts is heading us toward a train wreck. Unless the Administration fills in the blanks, I am concerned that we will be facing a massive continuing resolution this fall.

I was pleased to receive from you, Mr. Darman, a memorandum dated February 16th, to Executive Branch officials providing them with guidance on the President's budget plan. In that memo, you point out that the President's budget plan contains a residual freeze category where program detail is not presented in the document entitled "Building A Better America". Regarding that residual freeze category, your memo reads, in part, "the Reagan budget proposals for items within the residual category are to be treated as if they were the Bush Administration proposals for purposes of starting the budget process with the Congress. The alternative of starting with a nominal freeze on each and every account is an analytical possibility--but it is less practical at this stage than starting with the Reagan marks". If I understand that directive correctly, it represents progress.

I want to also thank you, Mr. Darman, for your responsiveness to my request for detailed line-item information for all thirteen Appropriation Subcommittees. We received that information yesterday and it has been helpful.

So, we are making progress, Mr. Darman. I want to encourage you to continue to work with us on the difficult challenges that lie ahead. You will find Congress more than willing to meet you half way if you will just level with us and the American people.

(The letters follow:)

LETTER FROM ROBERT C. BYRD

February 17, 1989

The Honorable Richard G. Darman
Director
Office of Management and Budget
Old Executive Office Building
Washington, D.C. 20503

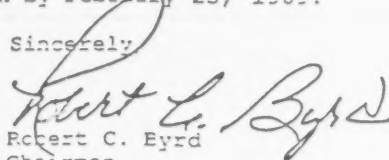
Dear Mr. Darman:

I look forward to your appearance before the Appropriations Committee on February 28, 1989, as part of our Fiscal Year 1990 budget overview hearings. I am sure that you share my interest in having this hearing provide Members of the Committee an opportunity to discuss with you the President's specific budget proposals.

To help insure that this hearing is meaningful and productive, I request from you account level detail for FY 1989 enacted and President Reagan's FY 1990 requests versus your proposals in terms of budget authority, prior-year outlays, new outlays, and total outlays. This information should be provided, by Subcommittee, for those accounts that comprise the \$136 billion in "Nondefense (Mostly) Discretionary Spending" cited on page 127 of House Document 101-26, entitled "Building a Better America".

Please submit this information by February 23, 1989.

Sincerely,


Robert C. Byrd
Chairman

LETTER FROM SENATORS ROBERT C. BYRD AND JIM
SASSER

February 14, 1989

The President
The White House
Washington, D.C.

Dear Mr. President:

We commend you on your first State of the Union address last Thursday evening. The tone of your remarks showed your belief that Government can be a constructive force for the good of the people of this Nation, rather than their enemy.

As you know, under the provisions of the Budget and Accounting Act of 1921, as amended, 31 U.S.C. 1105(a)(22), the President shall submit to the Congress:

"a statement of budget authority, proposed budget authority, budget outlays, and proposed budget outlays, and descriptive information in terms of --

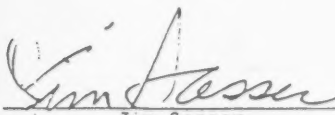
- (A) a detailed structure of national needs that refers to the missions and programs of agencies (as defined in section 101 of this title); and
- (B) the missions and basic programs."

President Reagan complied with this requirement by submitting his budget for fiscal year 1990 on January 9, 1989, accompanied by detailed supplementary materials.

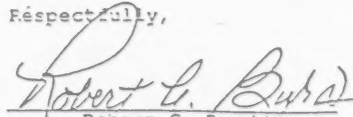
It is our understanding that you intend to submit budget amendments for selected programs cited in your message entitled "Building a Better America", which Congress received on February 9, 1989. For any accounts for which budget amendments are not received, Congress has no alternative other than to treat the requests contained in the Budget Appendix submitted by President Reagan, as your own. It is unclear whether that is your intent. If it is not, we hope to receive all of your proposed changes to President Reagan's budget in the near future.

We look forward to working with you in the coming months on the many difficult challenges facing our Nation.

Respectfully,



Jim Sasser
Chairman
Committee on the Budget



Robert C. Byrd
Chairman
Committee on Appropriations

MEMORANDUM FROM RICHARD G. DARMAN

February 16, 1989

M-89-13

MEMORANDUM FOR HEADS OF DEPARTMENTS AND AGENCIES

FROM: Richard G. Darman *R. G. Darman*
 Director

SUBJECT: Guidance to Executive Branch Officials on the President's Budget Plan

The purpose of this memorandum is to provide you with guidance in preparing testimony and commenting publicly on the President's 1990 budget plan, presented to Congress February 9th.

Although the situation varies by agency, most of the budget is available in detail in the book entitled "Building a Better America." The initiatives, reforms, natural declines, and special obligations discussed in the book are straightforward -- as is their rationale. They should be presented and defended directly. The President's budget plan does, however, contain a residual (nominal) freeze category where program detail is not presented in the book. This category is frozen in the aggregate at the 1989 dollar level for outlays.

Each agency should first calculate which portions of its 1990 budget are in the residual freeze category. This can readily be done by first identifying those items in the agency budget that are explicitly described in the book. The remainder of the agency budget is in the residual category.

Items in this residual freeze category -- as indeed the entire budget -- are subject to negotiations with Congress. The negotiations may lead to decisions in detail or, quite possibly, broad caps on various categories of spending.

As discussed in the Cabinet meeting, and pending the outcome of the negotiations, the Reagan budget proposals for items within the residual category are to be treated as if they were the Bush Administration proposals for purposes of starting the budget process with the Congress. The alternative of starting with a nominal freeze on each and every account is an analytical possibility -- but it is less practical at this stage than starting with the Reagan marks. However, any agency may propose to OMB a different mix of budget authority and outlays within its portion of the residual freeze category, provided the outlay total is not changed. If such an alternative mix is approved, it may be presented to the Congress.

The President has identified his priorities -- about which we would expect to be firm. But in the residual freeze area, the intention is to be flexible. With respect to the residual freeze category, therefore, it is our clear expectation that there will be many cases in which an alternative mix will be judged desirable and/or necessary.

Please ensure that all appropriation and budget justification materials continue to be submitted to this office for review, as required by OMB Circular No. A-11 - Preparation and Submission of Annual Budget Estimates. Similarly, agency draft bills, testimony and reports to Congress on authorizing and other substantive legislation should be submitted in accordance with OMB Circular No. A-19 - Legislative Coordination and Clearance. In cases where necessary authorizing or substantive legislation has not yet been submitted to OMB, we ask that you please do so as soon as possible.

If you have questions concerning this memorandum, please have appropriate staff contact the budget examiner for your agency.

Thank you.

INTRODUCTION OF MR. DARMAN

The CHAIRMAN. Senator Hatfield, the ranking member, I yield to him for whatever he wishes to say at this point.

Senator HATFIELD. Thank you, Mr. Chairman. I have no opening statement at this point. I would like to, of course, have an opportunity for questions later on, but I would defer at this time to your schedule.

The CHAIRMAN. All right. I thank Senator Hatfield.

Now, Mr. Darman, if you would proceed with your statement, you may read it in its entirety or you may capsule it, whichever you prefer, and then we will proceed with questions, and we will proceed on the 10 minute basis, which is not a good basis in my judgment, but I suppose under the circumstances it is about the best that we can utilize.

We will proceed by order of seniority, going back and forth. Yes.

The CHAIRMAN. If there are members who wish to include opening statements in the record at this point, they may do so and those statements will be included in their entirety. Mr. Darman.

OMB DIRECTOR DARMAN'S OPENING REMARKS

Mr. DARMAN. Thank you very much, Mr. Chairman. Mr. Chairman, I have a statement as you know which would probably take about 12 or 13 minutes to read. May I, with your permission, ask that the statement and its appendices be included in the record in its entirety, and I will try to abbreviate it in the interest of economizing on the use of your time.

The CHAIRMAN. Yes, it will be included in the record in its entirety.

Mr. DARMAN. Thank you very much, Mr. Chairman.

[The statement follows:]

STATEMENT OF RICHARD G. DARMAN

DIRECTOR

OFFICE OF MANAGEMENT AND BUDGET

THE PRESIDENT'S BUDGET PROPOSALS

Chairman Byrd, Senator Hatfield, and distinguished members of the Senate Committee on Appropriations, please let me thank you very much for this opportunity to discuss President Bush's budget proposals. I appear before you in what I hope you will find to be a constructive spirit, seeking to advance our common objective: the prompt enactment of a responsible budget program that can meet the Gramm-Rudman-Hollings deficit reduction targets, on schedule.

Building A Better America:
The President's Proposals

In seeking to meet this objective, the President has suggested that a responsible set of budget proposals must pass several basic tests:

- o They must attend to fundamental obligations -- such as the payment of interest, the protection of national security, and the funding of social security.
- o Within the limits of scarce resources:
 - they must address special obligations (to the poor, as through means-tested entitlement programs and incentives for child care; and to future generations, as through environmental protection);
 - they must begin to remedy problems inherited from the past: the scourge of drugs; the crisis in the savings and loan sector; the failure to invest adequately in the modernization and clean-up of nuclear weapons production; and

- they must advance priorities for future American growth and competitiveness (as through measures to encourage sound investment in research, education, enterprise, and longer-term productivity).
- o They must do all these things while also restoring fiscal balance -- meeting the Gramm-Rudman-Hollings targets, without raising taxes, and without threatening the continuation of what is now America's longest period of sustained peacetime economic growth.

The President's proposals were presented to the Congress on February 9 in a 193-page volume titled, Building A Better America. His proposals meet the several tests I have noted, and I would respectfully request that they be included in the record for your further consideration.

In addition to the 193-page volume, we have provided the Congress with the following:

- o On February 9, 1989: A "General Explanation of the President's Budget Proposals Affecting Receipts," containing an in-depth discussion of 11 specific governmental receipt proposals, 1989-1993 (55 pages).
- o On February 16, 1989: A Supplementary Data Package of 28 pages comprised of the following documents:
 - "Bridge from Reagan to Bush G-R-H baseline";
 - "FY 1990 non-Defense options, by function/subfunction";
 - "Economic and technical changes since January, 1989-1993";
 - "Adjustments for credit reform component of Reagan Budget, 1989-1993";
 - "Asset sales component of Reagan vs. Bush Budgets, 1989-1993";
 - "Bush structural reforms vs. current services, 1989-1993";
 - "National defense budget levels, 1989-1993."
- o On February 18, 1989: Another Supplementary Data Package of 491 pages comprised of the following documents:

- "FY 1990 Bush Budget priority programs by Bipartisan Budget Agreement category/function/subfunction/account";
- "FY 1990 mandatory residual options by function/subfunction/account";
- "FY 1990 Defense residual options by function/subfunction/account"; and
- -- "FY 1990 non-Defense discretionary residual options by function/subfunction/account."
- o On February 21 and 22, 1989: Appendices to testimony, comprised of the following documents:
 - "Initial Presentations of Budget Data by New Presidential Administrations, 1969-1989";
 - "Areas of Priority Initiative Spending";
 - "Receipts Proposals and Priority Receipts Initiatives";
 - "Mandatory Programs That Naturally Decline Under Current Law";
 - "Structural Reforms in Mandatory Programs";
 - "Applying the Residual Freeze";
 - "Flows Associated with Financial Sector Reform";
 - -- "Rescissions and Supplementals for Fiscal Year 1989";
 - "Receipts, Outlays and Projected Deficits"; and
 - "President Bush's budget presented in Budget Summit Framework".
- o On February 24, 1989: "Supplementary Data Package presented to the Appropriation Committees" -- 568 pages consisting of:
 - "FY 1990 Bush Budget Priority Programs by Appropriation Subcommittee/Agency/Account," 188 pages; and
 - "FY 1990 Residual Options by Appropriation Subcommittee/Agency/Account," 380 pages.

With these various submissions, and through informal consultation as well, I think it fair to say that we have submitted more data and explanation than any new President has done at a comparable stage of his Presidency in the modern budgeting era. (Please see Appendix A.)

Changing A Habit of Mind:
From Wonderland Budgeting to Common Sense Budgeting

The initial presentation of the President's proposals stirred a bit of attention for its effort to change a local habit of mind. That habit has a curious Wonderland quality. It is described by a phrase that is unknown to most of the country, but common among Washington budgeteers: "current services baseline" budgeting. Let me try to put this in perspective.

The "current services" approach tends to suggest that all programs funded in the past must be funded at at least equivalent service levels in the future -- with a built-in upward adjustment for inflation and other factors. In a sense, it treats spending programs as immortal. And it treats inflation as an acceptable given.

If a program is preserved and increased, but not quite as fast as inflation -- if it grows, say, from 100 to 103 -- then in the terminology of the current services Wonderland, it is said to be "cut." And political leaders in the Executive Branch and the Congress often take credit for "cutting" the deficit as they thus increase spending. What they cut, of course, is the "current services" baseline deficit, while the actual deficit may continue to rise.

In ordinary life, 103 is not a "cut" relative to 100. But in the world of "current services," things are different. It is a Wonderland phenomenon: a "cut" is really an increase; a deficit said to be going "down" is really going up.

I do not mean to suggest that the concept of "current services" is utterly inappropriate for some kinds of analysis. Indeed, although we have not budgeted on the basis of current services, we have recognized the Congress's analytic interest. Accordingly, we have provided the Congress with all of the necessary economic and technical assumptions to establish a current services baseline or to modify the prior current services baseline in light of President Bush's economic and technical assumptions.

Let me please make clear that the critique of "current services" is not confined to discretionary programs. Some of the most curious cases involve entitlements. Consider Medicare, for example. President Bush is proposing to increase Medicare by about \$8 billion in FY'90 relative to FY'89 -- from \$84.5 billion to \$92.5 billion. Advocates of current services budgeting claim that that proposed increase of \$8 billion should be called a "cut" of \$5 billion. This defies common uses of language. But worse: it is utterly phony.

The curious "current services" baseline not only increases Medicare expenditures for inflation, utilization, and growth in the beneficiary population. It also conveniently assumes that several current provisions will all disappear -- for Medicare's capital cost reimbursement (at 85%), clinical lab reimbursements, and supplementary medical insurance premium payments (25% premium floor). That is, current provisions are not used in calculating "current services"!

If these current provisions were to disappear, as assumed under "current services," Medicare's expenditures would be almost \$2 billion higher than if the provisions were to remain as they are today. Conversely, if the current reimbursement and premium provisions were to stay as they are, Medicare expenditures would be almost \$2 billion lower than the artificial "current services" projection.

So, with this curious form of "current services" accounting, if the Congress simply decides to extend the current Medicare provisions, Medicare will be said to be "cut" by almost \$2 billion. That is, if the program increases not by our recommended \$8 billion, but by over \$11 billion -- with today's provisions simply extended -- a fictitious "cut" of almost \$2 billion will be claimed. I would contend that this is fundamentally misleading.

But having expanded upon the nature of our critique, let me emphasize: we should not get lost in the technicalities of alternative baselines. The larger issue involves a habit of mind. If the real world deficit is to be reduced, programs must not be assumed to be immortal. Inflation must not be built in as given. And last year's level of service in every program must not be treated as the presumed minimum acceptable level for next year.

The frame of reference must be made more common-sensical. Next year's budget must be framed in relation to last year's actual spending -- and in relation to available resources and deficit targets -- not in relation to some hypothetical, perpetually expanding "current services" baseline.

There have been too many compromises announcing heroic "savings" measured against ethereal, misleading constructs. It should be little wonder that fictional "savings" have failed to materialize.

The fiction should not continue. The deficit is rising. It's time to do something real.

Shifting Perspective:
From Preoccupation with the Present to
Investment in the Future

Whatever one's views on the Wonderland budgeteers' habit of mind, there is another issue of perspective that is, I think, even more important. Whether we budget from last year's levels, a "zero base," "current services," or any other reference point, it is essential that we give greater attention to investment in the future. As a matter of analysis, that means we must attend to the relative emphasis given to new spending for current transfers and consumption versus new spending for future gains in productive power and the quality of life.

Our freedom for spending initiatives is limited. We are constrained by problems from the past and obligations to the present. But within the limits set by these constraints, President Bush's proposed initiatives tilt toward the future.

They emphasize:

- o Investment in research and development -- with major funding increases for basic science, biomedical research, space, and the superconducting super-collider; as well as proposed improvements in the R&E expense allocation rules and the Research and Experimentation tax credit.
- o Investment in education and child development -- with proposals for a new merit schools program; a new National Science Scholars program; increased funding for historically black colleges, magnet schools, Head Start, and experimentation and innovation; as well as a new

refundable tax credit of up to \$1000 for each child under 4 with a working parent in low-income families, and a related proposal to make the existing child care credit refundable; along with a restoration and doubling of the adoption expense tax deduction.

- o Investment in the protection of the environment -- with proposals for clean coal technology development, a new Clean Air Act, postponement of OCS drilling off of California and Florida; as well as tougher regulation and enforcement for hazardous waste clean-up, ocean dumping, and protection of wetlands.
- o Investment in combatting drug abuse -- with proposals that would increase outlays by almost \$1 billion for fiscal year 1990.
- o Investment in the creation of incentives for new economic opportunity -- with proposals for a new longer-term capital gains initiative, and provision for up to 70 enterprise zones.

The list of seemingly worthy claims always exceeds available resources. It is limited only by human imagination. The necessity for choice is inescapable. (For a summary of President Bush's priority choices, please see Appendices B and C). But in making choices, it is important to note: the voters of the present are well-represented; the citizens of the future are less so. At the margin of choice, the citizens of the future must depend upon the wisdom and generosity of a present generation that is willing to invest in the future.

But "How Do We Pay?"

Growth, Priorities, and Balanced Restraint

But, the question is rightly asked, "How do we finance all this?" The answer is straightforward.

The first and most important contributor is economic growth. With a growing economy -- and no change in current law -- revenues are projected to increase from \$978.6 billion in fiscal year 1989 to \$1.060 trillion. That's an increase of more than \$80 billion. (The Congressional Budget Office estimates even higher revenues than the Administration.) That is no small amount of money: it is more than the GNP of 137 countries.

Even so, with the claims made by deficit reduction, fundamental and special obligations, problems from the past, and priorities for initiative and investment, there is also need for restraint on the growth of the remainder of the budget. This need is mitigated somewhat by certain mandatory programs that naturally decline. (See Appendix D.) It is mitigated further by our ability to make sensible reforms in programs that would otherwise be an excessive drain on limited resources. (See Appendix E.) Still, in order to meet the Gramm-Rudman-Hollings targets, there remains a need to freeze the remainder of the budget as follows: freeze all retirement COLAs for federal civilian and military employees for one year; freeze defense budget authority at zero real growth for one year; and freeze residual non-defense spending (other than in areas of priority initiatives) at 1989 levels for one year. (See Appendix F.)

With these steps, it is possible to fund necessary and desirable program growth while also reducing the budget deficit below the targets of \$100 billion in FY 1990 and zero in FY 1993. (See Appendix I.)

The Need to Negotiate:

"We Cannot Settle for Business as Usual"

That said, I should emphasize we do not pretend to have either all the answers or the only acceptable set of answers. We have offered a set of proposals that we believe have merit. We look forward to learning of other proposals -- and to discussing them on the merits.

We mean to be cooperative.

But this, of course, is not enough. We cannot unilaterally produce a budget. We in the Executive Branch cannot legislate. We can offer and exchange views. But in the end, we must come to an Executive-Legislative agreement. To that end -- as a matter of practical reality -- we must negotiate. The only question is whether we do so promptly or late.

From our perspective, serious negotiation would best begin sooner rather than later. Although the real economy remains strong, interest rates are rising and markets seem less firm than one would wish. Our government is divided between the two great parties. That division is viewed by some as a formula for stalemate -- and stalemate is fraught with risk.

The risks are economic: if we do not act responsibly, and in a timely fashion, rising interest rates may cause the economy to founder -- creating significant human costs in the process. And the risks are political: if we do not act responsibly, and in a timely fashion, public cynicism about our collective capacity to govern may only deepen.

But it need not be so. The President has said that this is not time to settle for business as usual. Our job, as we see it, is to do our utmost to make divided government work. We are prepared to negotiate in good faith, in a bi-partisan spirit -- to work day and night, if that's what it takes, to reach a constructive agreement.

In that spirit, I would be pleased to try to respond to your questions. May I thank you again for inviting me to appear before you today.

Attachments: Appendices A through J

Appendix A

INITIAL PRESENTATIONS OF BUDGET DATA BY NEW PRESIDENTIAL ADMINISTRATIONS—1969–1989

During the past 20 years, the Presidency has changed hands five times: January 1969, when President Nixon succeeded President Johnson; August 1974, when President Ford succeeded President Nixon; January 1977, when President Carter succeeded President Ford; January 1981, when President Reagan succeeded President Carter; and January 1989, when President Bush succeeded President Reagan.

Because a President who leaves office following a November general election presents his last budget request to Congress in January, shortly before the inauguration of his successor, the new President is given the opportunity to transmit an amended budget to Congress. He is under no legal obligation to do so. Of the four Presidents listed above who took office in January, each transmitted a revised budget to Congress. However, the extent of the revisions and the amount of detail provided has varied substantially—as suggested by the following summary.

<i>President</i>	<i>Submission</i>	<i>Scope</i>	<i>Date</i>
Nixon:	12-page memorandum.	Estimates for 1969 and 1970; reestimate of receipts postponed; no out-years; no current services.	April 15, 1969
Carter:	101-page compilation of Message and tables.	Estimates for 1977 and 1978; no comparison with or use of current services baseline; disclaimer: "The 1978 budget is essentially still President Ford's budget, with only such limited revisions as my Administration has had time to make."	February 22, 1977
Reagan:	"Program for Economic Recovery"	1981–86; program changes—but with line for "budget savings to be presented subsequently."	February 18, 1981
	"1982 Budget Revisions."	BA/outlays by function, 1980–82 (compared with Carter, not with current services)—but with "additional savings to be proposed."	March 21, 1981
	"1982 Budget Revisions, Additional Details or Budget Savings."	Proposed program changes (not all) with BA/outlays, 1981–86.	April 7, 1981

President	Submission	Scope	Date
Bush:	"Remarks by the President to the Joint Session of Congress," 9 pages, with supplement entitled <i>Building a Better America</i> , 193 pages.	1989-93; proposed complete budget, including specific program initiatives (with outlays by function), reforms, natural declines, and special obligations.	February 9, 1989
	"General Explanation of the President's Budget Proposals Affecting Receipts," 55 pages.	In-depth discussion of 11 specific governmental receipt proposals, 1989-93.	February 9, 1989
	Supplementary data package provided to the Budget Committees, 28 pages.	Bridge from Reagan to Bush G-R-H baseline.	February 16, 1989
		FY 1990 Non-Defense Discretionary Residual Options, by Function/Subfunction.	
		Economic and technical changes since January, 1989-1993.	
		Adjustments for Credit Reform Component of Reagan Budget, 1989-1993.	
		Asset Sales Component of Reagan vs. Bush Budgets, 1989-1993.	
		Bush Structural Reforms vs. Current Services, 1989-1993.	
		National Defense Budget Levels, 1988-1993.	
	Supplementary data package provided to the Budget Committees, 491 pages.		February 18, 1989
	192 pages	FY 1990 Bush Budget Priority Programs by FY 90 BBA Category/Function/Subfunction/Account.	
	110 pages	FY 1990 Mandatory Residual Options by Function/Subfunction/Account.	
	4 pages	FY 1990 Defense Residual Options by Function/Subfunction/Account.	
	185 pages	FY 1990 Non-Defense Discretionary Residual Options by Function/Subfunction/Account.	
	"Testimony Before the House and Senate Budget Committees," 8 pages.	Explanations of both the President's priorities and how to pay for them.	February 21 and 22, 1989
	Appendices to the Testimony, 14 pages	Initial Presentations of Budget Data by New Presidential Administration—1969-1989.	February 21 and 22, 1989
		Areas of Priority Initiative Spending.	
		Receipts Proposals and Priority Receipts Initiatives.	
		Mandatory Programs That Naturally Decline Under Current Law.	
		Structural Reforms in Mandatory Programs.	
		Applying the Residual Freeze.	
		Flows Associated With Financial Sector Reform.	

President	Submission	Scope	Date
Bush (Cont.):		Rescissions and Supplementals for Fiscal Year 1989. Receipts, Outlays and Projected Deficits. President Bush's Budget Presented in Budget Summit Framework.	
	Supplementary data package presented to the Appropriation Committees, 568 pages.		February 23, 1989
	188 pages	FY 1990 Bush Budget Priority Programs by Appropriation Subcommittee/Agency/Account.	
	380 pages	FY 1990 Residual Options by Appropriation Subcommittee/Agency/Account.	

Appendix B

PRESIDENT BUSH'S BUDGET—AREAS OF PRIORITY INITIATIVE
SPENDING

(In millions of dollars)

	1989		1990		Total Increase	
	BA	Outlays	BA	Outlays	BA	Outlays
Investing in R&D and Long-Term Productive Capacity						
Basic research.....	2,707	2,613	3,068	2,905	361	292
National Aeronautics and Space Administration.....	10,898	10,596	13,274	12,597	2,376	2,001
Superconducting Super Collider	100	100	250	206	150	106
National Institutes of Health	6,543	6,250	6,777	6,600	234	350
Census.....	655	672	1,497	1,587	842	915
Investing in People						
Department of Education.....	17,280	16,336	17,874	17,104	594	768
Ending the Scourge of Drugs						
Drug abuse	5,331	4,569	5,966	5,543	635	974
Prisons and other Justice Department programs.....	4,025	3,979	4,460	4,297	435	318
Meeting Special Obligations: A Kinder, Gentler America ¹						
Land and water conservation.....	206	240	206	214	—	4
Acid rain	190	92	710	120	520	28
Homeless:						
Fully fund the McKinney Act	466	408	746	496	280	88
Non-McKinney homeless initiative	—	—	50	25	50	25
Other assistance for homeless	125	92	211	124	86	32
Head Start.....	1,235	1,202	1,485	1,351	250	149
YES—Youth Engaged in Service.....	—	—	25	21	25	21
HIV/AIDS	1,287	1,217	1,600	1,377	313	160
Medicaid	34,301	34,301	37,616	37,616	3,315	3,315
Attending to Problems of the Past ²						
Atomic energy clean up and modernization.....	2,588	2,536	3,663	3,237	1,075	701
Federal Aviation Administration.....	6,591	5,733	7,743	6,639	1,152	906
Securing a More Peaceful World						
International affairs.....	17,598	16,660	19,314	17,677	1,716	1,017
Total (excluding double counts).....	111,631	107,239	125,974	119,234	14,343	11,995

¹ Social security and means-tested entitlement programs are fully funded, but they are not reflected in this table.

² The comprehensive reform package (involving public and private resources) for FSLIC is described in Section III B-1 of *Building a Better America*.

Appendix C

PRESIDENT BUSH'S BUDGET—RECEIPTS PROPOSALS AND PRIORITY
RECEIPTS INITIATIVES

(In billions of dollars)

	1989	1990	1991	1992	1993
Reagan proposals:					
Receipts ¹	—*	1.2	3.2	3.0	2.6
Offsetting collections ²	—	5.2	3.1	1.4	3.2
Total, Reagan proposals	—*	6.4	6.3	4.4	5.8
Bush proposals: —					
Establish child care credit ³	—	—0.2	—1.9	—2.2	—2.5
Restore and double adoption deduction	—	—*	—*	—*	—*
Provide credit for intangible drilling	—	—0.2	—0.3	—0.3	—0.4
Revise AMT for exploratory drilling by independents	—	—0.1	—0.1	—0.1	—0.1
Provide credit for tertiary enhanced recovery	—	—*	—*	—*	—*
Establish enterprise zones	—	—0.2	—0.2	—0.3	—0.4
Enhance long-term investment incen- tives	0.7	4.8	4.9	3.5	2.2
Extend existing telephone excise tax ⁴ ..	—	—	1.6	2.6	2.8
Total, Bush proposals	0.7	4.2	4.0	3.2	1.6
Total proposals	0.7	10.6	10.3	7.6	7.4

* \$50 million or less.

¹ Includes HI coverage of State and local employees, R&E allocation rules, R&E tax credit, IRS enforcement initiative, NRC and FEMA fees, and aviation-related taxes.² Includes credit user fees, service user fees, Outer Continental Shelf receipts, Arctic National Wildlife Refuge, Chlorofluorocarbon production rights, unassigned spectrum, and customs service. Does not include an increase in the veterans loan guarantee fee proposed in the January budget, and lease sales off the coast of California (sales #91 and #95) and the coast of southern Florida (sale #116, south of 26 degrees north latitude) proposed in the January budget.³ Includes the effect on outlays. Eligibility commences in 1990, but most refunds are not paid until 1991.⁴ Net of income tax offsets. Assumes extending the current tax of 3 percent.

Appendix D

**PRESIDENT BUSH'S BUDGET—MANDATORY PROGRAMS THAT
NATURALLY DECLINE UNDER CURRENT LAW**

(In millions of dollars)

	Current Services		Decrease
	1989	1990	
International affairs:			
Development and humanitarian aid, offsetting receipts	-480	-505	-25
Conduct of foreign affairs	15	9	-6
International financial, excluding Export-Import Bank	-68	-81	-13
Energy:			
Tennessee Valley Authority	540	300	-240
Nuclear waste disposal fund	-526	-538	-12
Nonconventional fuel	159	4	-155
Agriculture:			
Commodity Credit Corporation	13,036	12,645	-391
Crop insurance fund	1,049	356	-693
Commerce and housing credit:			
Ginnie Mae mortgage-backed securities	-210	-313	-103
Federal Housing Administration, excluding asset sales	1,537	586	-951
Federal Deposit Insurance Corpora- tion	3,807	-1,324	-5,131
National Credit Union Administra- tion	-169	-195	-26
Science and technology	189	152	-37
Transportation:			
Panama Canal fund	34	-4	-38
Education, training, employment, and social services:			
Guaranteed student loans	3,602	3,282	-320
Income security:			
Means-tested:			
Aid to Puerto Rico	908	825	-83
Supplemental Security Income	11,389	11,038	-351
Family support	9,847	9,581	-266
Earned Income Tax Credit	3,849	3,841	-8
Other:			
Disabled coal miners	1,529	1,505	-24
Pension Benefit Guaranty Corpora- tion	-301	-415	-114
Federal employee life insurance	-782	-842	-60
Low-rent public housing loans	788	503	-285

**PRESIDENT BUSH'S BUDGET—MANDATORY PROGRAMS THAT
NATURALLY DECLINE UNDER CURRENT LAW—Continued**
(In millions of dollars)

	Current Services		Decrease
	1989	1990	
Veterans benefits and services:			
GI bill and readjustment benefits	620	451	-169
Third-party reimbursement	-138	-304	-166
Loan guaranty fund, excluding fees and asset sales	1,758	1,582	-176
Administration of justice:			
Customs fee	-637	-771	-134
General government:			
OPM revolving fund	-11	-25	-14
Mineral and land payments	547	511	-36
Total	51,881	41,854	-10,027

Appendix E

PRESIDENT BUSH'S BUDGET—STRUCTURAL REFORMS IN MANDATORY PROGRAMS

(Outlays in billions of dollars)

	1989	1990	Dollar Change
Medicare	84.5	92.5	+8.0
Federal Employees Health Benefits	1.9	1.6	-0.3
Farm Support Payments	13.9	10.7	-3.2
Power Marketing Reforms	-0.6	-1.5	-0.9
Lump-Sum Federal Retirement Benefits	1.6	0.6	-1.0
Other ¹	2.9	2.0	-0.9
Total	104.2	105.9	+1.6

	1990	1991	1992	1993
Savings from Current Law:				
Medicare	-5.0	-8.1	-10.7	-13.6
Federal Employees Health Benefits	-1.2	-1.5	-1.8	-2.0
Farm Support Payments	-1.9	-1.8	-2.4	-2.4
Power Marketing Reforms	-0.9	-0.6	-0.5	-0.5
Lump-Sum Federal Retirement Benefits	-2.1	-2.2	-2.4	-2.5
Other ¹	-0.6	-0.2	-0.2	-0.4
Total	-11.8	-14.4	-18.0	-21.3

¹ Other includes a 1990 adjustment for electronic transfers of food stamp cash balances, reform of guaranteed student loans, and extensions of a 1 percent VA loan fee and VA asset sales.

Appendix F

PRESIDENT BUSH'S BUDGET—APPLYING THE RESIDUAL FREEZE

(Outlays in billions of dollars)

	1989	1990	Dollar Change	Percent Change
Freeze residual non-defense spending at 1989 levels ("nominal freeze") ¹	136.0	136.0	—	—
Freeze Federal retirement COLAs	51.2	52.7	1.5	2.9
Freeze defense budget authority at zero real growth ²	289.8	291.2	1.4	0.5
Total	477.0	479.9	2.9	0.6

¹ This nominal freeze applies to all programs except social security and other social insurance program benefits, means-tested entitlement benefits, programs subject to structural reforms, mandatory programs that decline naturally, initiatives (including S&L reform) specified in the Bush budget, net interest, undistributed offsetting receipts, and asset sales.

² The defense freeze is applied to budget authority for subfunction 051. Numbers presented above are the associated outlays.

Appendix G

PRESIDENT BUSH'S BUDGET—FLOWS ASSOCIATED WITH FINANCIAL
SECTOR REFORM

(In billions of dollars)

	1989	1990	1991	1992	1993	1989- 1999
FSLIC and RTC Account						
Disbursements:						
Old cases and other expenses:						
Administrative and miscellaneous	0.3	0.3	0.3	0.3	0.3	2.8
Notes issued	9.7	—	—	—	—	9.7
Interest on notes outstanding	1.4	1.5	1.1	0.9	0.8	9.2
Repayment of notes issued prior to 1987	—	—	0.2	—	0.2	0.5
Assistance payments	5.2	4.4	3.8	4.2	3.4	28.8
Liquidations	1.0	—	—	—	—	1.0
Total, old cases and other expenses	17.7	6.2	5.5	5.4	4.7	52.2
New cases:						
Assisted mergers	5.0	12.5	8.5	1.2	1.8	44.0
Liquidations	5.0	12.5	8.5	1.2	1.8	30.0
Total, new cases	10.0	25.0	17.0	2.4	3.6	74.0
Total disbursements	27.7	31.2	22.5	7.8	8.3	126.2
Collections (-):						
FICO proceeds (CEBA) (-)	-3.8	-3.3	—	—	—	-7.1
New REFCORP proceeds (-)	-10.0	-25.0	-15.0	—	—	-50.0
Insurance premiums:						
Before deductions (-)	-2.1	-2.3	-2.7	-2.9	-3.1	-31.6
Deduct (+):						
FICO (CEBA) interest	0.6	0.9	1.0	1.0	1.0	10.7
Secondary reserve credit	0.1	0.1	0.1	0.1	0.3	0.7
Defense new bond principal	—	1.7	1.7	—	—	3.3
Net premium income (-)	-1.4	0.4	0.1	-1.8	-1.7	-16.9
Proceeds from receivers and corporate-held assets (old cases) (-)	-1.4	-1.4	-1.2	-1.0	-1.4	-9.7
Income on investment balances (-)	-0.1	—	—	—	-0.1	-1.1
Other collections (-)	-0.4	-0.4	-0.4	-0.3	-0.3	-3.5
Total collections	-17.0	-29.8	-16.5	-3.2	-3.6	-88.3
FSLIC/RTC net outlays	10.7	1.4	6.0	4.6	4.7	37.9
Repayments of notes issued after 1986	0.4	0.3	0.1	—	1.1	19.2
Balance of FSLIC notes outstanding (end-of-year)	19.2	18.9	18.6	18.5	17.3	—
FSLIC/RTC cash/investment end-of-year balances (9/30/88 = \$1.9 billion):						
Balance for cases	0.6	0.5	0.5	0.5	0.5	0.5
Balance for new fund	—	—	—	1.0	2.1	8.8

**PRESIDENT BUSH'S BUDGET—FLOWS ASSOCIATED WITH FINANCIAL
SECTOR REFORM—Continued**

(In billions of dollars)

	1989	1990	1991	1992	1993	1989- 1999
Summary of Accounts Affected						
FSLIC net outlays	10.7	1.4	6.0	4.6	4.7	37.9
Treasury contribution to REFCORP interest	0.5	1.4	1.6	0.9	0.8	22.0
Additional FDIC collections	—	-0.8	-1.6	-1.7	-1.8	-19.9
Total budget outlays	11.1	1.9	6.0	3.8	3.7	39.9

Appendix H

PRESIDENT BUSH'S BUDGET—RESCISSIONS AND SUPPLEMENTALS
FOR FISCAL YEAR 1989

(In billions of dollars)

	Budget authority	Outlays	Revenues	Deficit
Rescissions ¹	*	*	—	*
Mandatory supplementals:				
Guaranteed student loans (pending from January)	—	0.3	—	0.3
Guaranteed student loans (change for economics)	—	0.4	—	0.4
VA compensation, pensions, and burial benefits	0.7	0.7	—	0.7
VA readjustment benefits	*	*	—	*
VA loan guaranty	0.3	0.3	—	0.3
TAA training and benefits	0.1	0.1	—	0.1
Other Supplementals: ²				
Forest Service firefighting	0.3	—	—	—
Student financial assistance	*	—	—	—
Foster care/adoption assis- tance ³	0.4	0.4	—	0.4
Justice (FSLIC)	*	*	—	*
Total supplementals	1.8	2.2	—	2.2
Other changes:				
Administrative actions:				
Advanced deficiency pay- ments	—	0.8	—	0.8
Strategic petroleum reserve ..	—	0.1	—	0.1
Substantive legislation:				
Guaranteed student loans	—	—*	—	—*
Capital gains tax reduction ..	—	—	0.7	-0.7
FSLIC	—	0.4	—	0.4
Amtrak unemployment in- surance tax	—	—	—*	—*
Treaty ratification:				
Compact of free association ...	0.2	0.2	—	0.2
Related debt service	*	*	—	*
Grand total	2.6	3.7	0.7	3.0

* Less than \$50 million.

¹ President Reagan's rescission proposals are withdrawn except for those that offset proposed spending increases.² Excludes supplementals that are entirely offsetting.³ Foster care/adoption assistance figures were not included in published numbers. All other supplementals were included.

Appendix I

PRESIDENT BUSH'S BUDGET—RECEIPTS, OUTLAYS, AND PROJECTED DEFICITS

(Assuming Prompt Implementation of the President's Proposals)
(In billions of dollars)

	1989	1990	1991	1992	1993
Receipts	979.3	1,065.6	1,147.6	1,218.6	1,286.6
Outlays, excluding asset sales.....	1,149.9	1,160.4	1,211.8	1,249.2	1,284.1
Deficit, excluding asset sales.	170.7	94.8	64.2	30.6	-2.5
G-R-H targets.....	136.0	100.0	64.0	28.0	0.0
Deficit, including asset sales ¹	163.7	91.1	61.9	26.8	-3.8

¹ The 1989 amount is \$0.4 billion higher than the February 9 estimate to adjust for all supplementals—including foster care/adoption assistance, which was omitted in the February 9 calculation.

Appendix J

PRESIDENT BUSH'S BUDGET—PRESENTED IN BUDGET SUMMIT
FRAMEWORK

(In billions of dollars)

	1989 February Estimate	1990 Bush Budget	1990 Bush vs. 1989 Est.
Defense:			
Priority:			
Department of Defense:			
Budget Authority	290.2	299.3	+9.1
Outlays	289.8	291.2	+1.4
Atomic energy cleanup:			
Budget Authority	2.6	3.7	+1.1
Outlays	2.5	3.2	+0.7
Other:			
Budget Authority	6.0	6.0	—
Outlays	5.9	5.9	—
Total:			
Budget Authority	298.8	309.0	+10.2
Outlays	298.3	300.4	+2.1
International Discretionary:			
Priority:			
Budget Authority	17.6	19.3	+1.7
Outlays	16.7	17.7	+1.0
Freeze:			
Budget Authority:			
Option 1 (RR method)	0.7	0.1	-0.6
Option 2 (nominal outlays ^a)	0.7	0.7	—
Outlays	-0.3	-0.3	—
Total:			
Budget Authority:			
Option 1 (RR method)	18.3	19.4	+1.1
Option 2 (nominal outlays ^a)	18.3	20.0	+1.7
Outlays	16.3	17.3	+1.0
Domestic Discretionary:			
Priority:			
Budget Authority	47.5	55.5	+8.0
Outlays	56.9	62.1	+5.2
Freeze:			
Budget Authority:			
Option 1 (RR method)	95.9	91.3	-4.6
Option 2 (nominal outlays ^a)	95.9	94.1	-1.8
Outlays	120.2	120.2	—
Total:			
Budget Authority:			
Option 1 (RR method)	143.4	146.8	+3.5
Option 2 (nominal outlays ^a)	143.4	149.5	+6.2
Outlays	177.1	182.4	+5.2

**PRESIDENT BUSH'S BUDGET—PRESENTED IN BUDGET SUMMIT
FRAMEWORK—Continued**
(In billions of dollars)

	1989 February Estimate	1990 Bush Budget	1990 Bush va. 1989 Est.
Mandatory:			
Naturally Declining:			
Outlays.....	51.9	41.9	-10.0
Structural Reform:^b			
Outlays.....	104.2	105.9	+1.6
Freeze:			
Outlays.....	10.2	10.2	—
Others:			
Outlays.....	376.7	386.9	+10.2
Total (excluding double counts):			
Outlays.....	526.4	529.1	+2.7
Asset Sales and Prepayments:			
Budget Authority	-0.9	-1.4	-0.5
Outlays.....	-6.9	-3.6	+3.3
User Fees and Other Collections:			
Budget Authority	—	-5.2	-5.2
Outlays.....	—	-5.2	-5.2
Interest:			
Budget Authority	168.8	173.3	+4.5
Outlays.....	168.8	173.3	+4.5
Undistributed Offsetting Receipts:			
Budget Authority	-36.9	-36.9	—
Outlays.....	-36.9	-36.9	—
Total:			
Outlays.....	1,143.0	1,156.8	+13.8
Receipts.....	979.3	1,065.6	+86.4
Deficit.....	163.7	91.1	-72.6

^a Freeze option 2 is a nominal outlay freeze at the account level.

^b Includes portions of GSL and farm support payments counted in "Naturally Declining," and FEHB reform counted in "Domestic Discretionary—Priority."

PRESIDENT BUSH'S BUDGET PROPOSALS

Mr. DARMAN. Chairman Byrd, Senator Hatfield, distinguished members of the Senate Committee on Appropriations, please let me thank you very much for this opportunity to discuss President Bush's budget proposals. I appear before you in what I hope you will find to be a constructive spirit seeking to advance our common objective, the prompt enactment of a responsible budget program that can meet the Gramm-Rudman-Hollings deficit reduction targets on schedule. In seeking to meet this objective, the President has suggested that a responsible set of budget proposals must pass several basic tests.

They must attend to fundamental obligations such as the payment of interest, the protection of national security, and the funding of Social Security. Within the limits of scarce resources, they must address special obligations to the poor as through means tested entitlement programs and incentives for child care, and to future generations, as through environmental protection.

They must begin to remedy problems inherited from the past, the scourge of drugs, the crisis in the savings and loan sector, the failure to invest adequately in the modernization and cleanup of nuclear weapons production. And they must advance priorities for future American growth and competitiveness as through measures to encourage sound investment in research, education, enterprise, and longer term productivity.

They must do all these things while also restoring fiscal balance, meeting the Gramm-Rudman-Hollings targets, without raising taxes and without threatening the continuation of what is now America's longest period of sustained peacetime economic growth.

The President's proposals were presented to the Congress, as you have noted, Mr. Chairman, on February 9, in a 193 page volume entitled "Building a Better America." I would respectfully contend that his proposals meet the several tests that I have noted and would request that they too be included in the record for your further consideration.

The CHAIRMAN. They will be so included.

[CLERK'S NOTE.—The book has been retained in the committee files.]

DETAILED INFORMATION PROVIDED ON BUSH BUDGET

Mr. DARMAN. Mr. Chairman, my testimony notes that in addition to the 193-page volume, we have since provided the Congress with a host of additional data, and I appreciate your reference to it. I will not repeat it line by line, but I would note that on February 9 we submitted another 50-page document dealing with the revenue proposals, on February 16 another 28 pages of various and sundry items necessary to help the staff do comparative analyses.

We also submitted on February 18, 491 additional pages basically of line-by-line data, organized in ways requested by the Budget Committees. On February 21 and 22, I provided various appendixes noted in the testimony here. On February 24, as you have suggested, we provided another supplementary data package, this one 568 additional pages, consisting of the fiscal year 1990 Bush budget priority programs organized by appropriation subcommittee, by

agency, and by account, and then the same for all of the residual options organized in the same way. That's another 380 pages.

With these various submissions and through informal consultation as well, I think it fair to say that we have submitted more data and explanation than any new President has done at a comparable stage of his Presidency in the modern budgeting era.

CURRENT SERVICES—WONDERLAND BUDGETING

Mr. Chairman, I would with your permission make a few comments about current services budgeting, and then skip quickly over the remainder of my testimony. The initial presentation of the President's proposal stirred a bit of attention for its effort to change a local habit of mind.

That habit has a curious wonderland quality. It is described by a phrase that is unknown to most of the country, but common among Washington budgeteers, current services baseline budgeting. Let me try to put this in perspective.

The current services approach tends to suggest that all programs funded in the past must be funded at at least equivalent service levels in the future, with a built-in upward adjustment for inflation and other factors.

In a sense, it treats spending programs as immortal, and it treats inflation as an acceptable given. If a program is preserved and increased but not quite as fast as inflation, if it grows, say, from 100 to 103, then in the terminology of the current services wonderland, it is said to be cut. Political leaders in the executive branch and the Congress often take credit for cutting the deficit as they thus increase spending.

What they cut, of course, is the current services baseline deficit, while the actual deficit may continue to rise. In ordinary life, 103 is not a cut relative to 100, but in the world of current services things are different. It's a wonderland phenomenon. A cut is really an increase. A deficit said to be going down is really going up.

I do not mean to suggest that the concept of current services is utterly inappropriate for some kinds of analysis. Indeed, although we have not budgeted on the basis of current services, we have recognized the Congress' analytic interest. We have provided the Congress with all of the necessary economic and technical assumptions to establish a current services baseline or to modify the prior current services baseline in light of President Bush's economic and technical assumptions.

Let me please make clear that the critique of current services is not confined to discretionary programs. Some of the most curious cases involve entitlements. Consider Medicare, for example. President Bush is proposing to increase Medicare by about \$8 billion in fiscal year 1990 relative to fiscal year 1989, from \$84.5 billion to \$92.5 billion.

Advocates of current services budgeting claim that that proposed increase of \$8 billion should be called a cut of \$5 billion. This defies common uses of language, but worse, it is utterly phony. The curious current services baseline not only increases Medicare expenditures for inflation, utilization, and growth in the beneficiary population, it also conveniently assumes that several current provisions

will all disappear—for Medicare's capital cost reimbursement now at 85 percent, for clinical lab reimbursements, and the floor for supplementary medical insurance premium payments which now have a 25-percent premium floor.

That is, current provisions are not used in calculating current services. If these current provisions were to disappear as is assumed under current services, Medicare expenditures would be almost \$2 billion higher than if the provisions were to remain as they are today.

Conversely, if the current reimbursement and premium provisions were to stay as they are, Medicare expenditures would be almost \$2 billion lower than the artificial current services projection.

So with this curious form of current services accounting, if the Congress simply decides to extend the current Medicare provisions, Medicare will be said to be cut by almost \$2 billion. That is if the program increases not by our recommended \$8 billion, but by over \$11 billion, with today's provisions simply extended, a fictitious cut of almost \$2 billion will be claimed.

I would contend that this is fundamentally misleading. But having expanded upon the nature of our critique, let me emphasize we should not get lost in the technicalities of alternative baselines. The larger issue involves a habit of mind. If the real world deficit is to be reduced, programs must not be assumed to be immortal. Inflation must not be built in as given, and last year's level of service in every program must not be treated as the presumed minimum acceptable level for next year.

The frame of reference must be made more commonsensical. Next year's budget must be framed in relation to last year's actual spending and in relation to available resources and deficit targets, not in relation to some hypothetical perpetually expanding current services baseline.

There have been too many compromises announcing heroic savings measured against ethereal misleading constructs. It should be little wonder that fictional savings have failed to materialize. The fiction should not continue. The deficit is rising. It is time to do something real.

INVESTING IN THE FUTURE

Now Mr. Chairman, I might just note the remainder of this testimony, which I also take seriously but would not take your time to read, attempts to make a couple of rather basic points. One is that even more important than this issue of what baseline we use is the habit of mind involving our attitude toward the future and investment in the future.

I attempt to argue that the President's initiatives are tilted toward the future insofar as they emphasize investment in research and development, investment in education and child development, in the protection of the environment, in combating drug abuse, and in the creation of incentives for new economic opportunity.

I then go on to note that obviously there are competing claims. They cannot all be satisfied, and there is a need, of course, to pay

for all this, and I contend that we have a credible proposal for addressing the how do we pay issue, but your introductory comments suggest that you are not yet totally satisfied with this point, and so I assume we will get a chance to talk about that a bit further and will not take your time at the moment.

Finally though, Mr. Chairman, I should say and emphasize that we do not pretend to have either all the answers or the only acceptable set of answers. We have offered a set of proposals that we believe have merit. We look forward to learning of other proposals and discussing them on their merits.

We do mean to be cooperative, but this of course, is not enough. We cannot unilaterally produce a budget. We in the executive branch cannot legislate. We can offer and exchange views, but in the end we must come to an executive-legislative agreement, and to that end, as a matter of practical reality, we must negotiate.

GETTING BUDGET NEGOTIATIONS UNDERWAY

The only question is whether we do so promptly or late. From our perspective, serious negotiation would best begin sooner rather than later, for although the real economy remains strong, interest rates are rising and markets seem less firm than one would wish. Our Government is divided between the two great parties. That division is viewed by some as a formula for stalemate, and stalemate is fraught with risks.

The risks are economic if we do not act responsibly and in a timely fashion. Rising interest rates may cause the economy to founder, creating significant human costs in the process. And the risks are political. If we do not act responsibly and in a timely fashion, public cynicism about our collective capacity to govern may only deepen.

But it need not be so. The President has said that this is not the time to settle for business as usual. Our job as we see it is to do our utmost to make divided Government work. We are prepared to negotiate in good faith in a bipartisan spirit, to work day and night if that is what it takes, and I suspect it will be what it takes, to reach a constructive agreement.

It is in that spirit, Mr. Chairman, Senator Hatfield, and other distinguished members of the committee, that I would be pleased to try to respond to your questions and I thank you again for inviting me to appear before you today.

The CHAIRMAN. Thank you, Mr. Darman. I thank you for your statement. I agree with what you have to say regarding the current services budget, but I do not agree that that is an Alice in Wonderland approach. It seems to me that what we have here in the approach of the administration is a combined Reagan-Bush budget by virtue of what you have indicated to the executive agencies in saying that when they appear before congressional committees where the blanks are not filled in, they are to take the Reagan marks.

A REAGAN-BUSH BUDGET

So what we have here is a hybrid. We have the Reagan budget with all the line items filled in. We have a statement by Mr. Bush

with no formal amendments to the Reagan budget, but some proposals as to certain priorities of the President, and then a residual category which adds up to \$136 billion, and which some have referred to as the black box, or the black hole. Or to remember the "magic asterisk" of David Stockman days, perhaps that is as good an appellation as any that can be given to it.

Would it be accurate then to describe this as a Reagan-Bush budget?

Mr. DARMAN. Yes, it would, Mr. Chairman, and might I make one or two comments?

The CHAIRMAN. Yes.

HISTORICAL PERSPECTIVE ON LEVEL OF DETAIL IN BUDGET SUBMITTED BY NEW PRESIDENTS

Mr. DARMAN. Could I please call to your attention appendix A—you need not turn to it, but that is at least what I am referring to in my own testimony—in which I have tried to summarize what presentations were made by other presidents at a comparable stage of their administration. At this stage, President Nixon when he had come into office had as yet provided nothing, zero, to the Congress. His ultimate presentation in its entirety was a 12-page memorandum. And President Carter——

The CHAIRMAN. Mr. Darman, you are taking my time.

Mr. DARMAN. Oh, I am sorry, Mr. Chairman.

The CHAIRMAN. We have that information. You have laid it all out. You have indicated that this is a Reagan-Bush budget.

Mr. DARMAN. Well, I wanted to make——

The CHAIRMAN. You have sent reams of paper up here, and that is what you are referring to now.

Mr. DARMAN. But I wanted to add one comment, then, just one——

The CHAIRMAN. All right. All right.

Mr. DARMAN. That is on that page. President Carter when he submitted a 101 page budget, very much less than we, concluded by saying the 1978 budget is essentially still President Ford's budget with only such limited revisions as my administration has had time to make.

So all I would ask, sir, is that you consider that in the time available what we have done, I think, is really quite reasonable.

The CHAIRMAN. Very well. I would say in response to that, that even though there are pages and pages and pages, and you have enumerated them and added them and come out with totals, they do not change one dime in the Reagan budget. Only formal amendments submitted by Mr. Bush to the Speaker of the House and the President pro tempore of the Senate can amend those figures.

I grant that you have submitted a lot of material, but you are already talking about negotiations. We have got to have more than just pages of material. We have got to have from Mr. Bush amendments showing where he stands. He states in this book here that that is what the President is for, is to lead. Now he came before the American people and he told us all in a joint session what his priorities were.

He gave us the gain, but he did not give us the pain. He did not say where the cuts are going to come from. What he says is we are going to meet that deficit target. We are not going to raise any taxes. We are going to increase these items, these priorities, A, B, C, and D. But he does not tell the American people that there is some pain associated with all these good things.

Now we come to the pain, and what we are asking Mr. Bush to do is to show down. Where does he stand? Where is that leadership? Is he abdicating that leadership? When he does not show down, he leaves the blanks. And you tell us that we are to use his figures as bases on which to ask questions of your department heads. So it is a political budget that we are dealing with.

PROPOSED PROGRAM TERMINATIONS

Now my second question. President Reagan in his budget proposes the termination of 82 programs that were funded in fiscal year 1989. Among these programs are many that Congress has funded in the past, notwithstanding President Reagan's proposed terminations; they include Amtrak, essential air service, mass transit grants, SBA disaster loans, Appalachian Regional Commission, and many, many others.

Is it now the position, Mr. Darman, of the Reagan administration, that the fiscal year 1990 budget requests for these 82 programs is zero? That is where Mr. Reagan puts them. He has zeroed them out, and you have said in your memo to department heads that where we do not fill in the blanks you in testifying before committees are to accept the Reagan marks.

Well, the Reagan mark is zero on 82 programs. Since they were not in the list of Bush priorities, and therefore in accordance with your directive, is it now the position of the Bush administration that those are likewise zeroed out for fiscal year 1990?

Mr. DARMAN. Thank you, Mr. Chairman, just on one point, and then I will respond immediately. On the point about not having described any pain, if I could respectfully suggest, we have come under quite a lot of criticism for the Medicare proposals and for COLA freezes and for things related to power marketing administrations and farm program initiatives, and so on, where it has been said that we have proposed things that are painful. So I think there ought not to be a double standard used in looking at us.

We have made several proposals which several people do consider painful although we might argue about the merits on that. On your specific question, what this directive says, and as you know, I provided it to you in order that you would understand exactly what we are trying to do, what it does say is in order to get the process moving, the Reagan proposal is on the table unless there is a specific removal of the Reagan proposal, and what we have told agencies is if you have proposals for changes, please submit them to OMB, but they have to be offset. As a general matter, we will be disposed to consider those favorably.

At the moment, I do not have proposals except in limited extent from the area of housing and urban development. In the other areas, the Reagan proposals—well, in all areas the Reagan proposals are the ones that are on the table to start the process, including

the 82 program eliminations you referred to, for purposes of starting the process.

BUDGET AMENDMENTS ARE ON THE WAY

I might say further, Mr. Chairman, that we do intend, and will very promptly have the necessary budget amendments. For anything in which we have not provided a budget amendment to you, we will, through incorporation by reference, make clear that the amendments you already have that are the Reagan amendments are operative. So you will have a complete set.

The CHAIRMAN. That are the Bush amendments, you mean?

Mr. DARMAN. We will provide the Bush amendments, but they will be in the form of amendments to the Reagan set that you already have.

The CHAIRMAN. Yes.

Mr. DARMAN. The combination will then be a complete set, and we will have a covering memorandum which explains explicitly that the Reagan ones we are incorporating by reference for purposes of getting the process moving.

The CHAIRMAN. Very well. I will be brief because I want other members to have their opportunities as well. As to the 82 programs that are eliminated in the Reagan budget, will the Bush amendments put them back on the table, or will the Bush amendments take them out?

Mr. DARMAN. If the Bush amendments were to come up today, those 82 proposals would be still on the table as incorporated by reference as part of the Bush proposals. However, as a formal procedural matter, you would have those from which to start as the administration's current position. We are saying something at the same time, however, which is less formal, but I think more important.

It is that for a large number of those proposals we recognize that the Congress does not intend to adopt the position represented by zeroing them out, and that we are not as concerned about those programs as the ones in our priority initiative area, and so we will attempt to be flexible in discussing the kinds of things that we would accept as alternatives to that in order to finance initiatives.

The CHAIRMAN. Just that I might get a clear understanding in my own mind of your response to this question, then I will turn to Senator Hatfield. Are you or are you not saying that those 82 programs which were eliminated by Mr. Reagan and which in his budget are in effect zeroed out—those are zeros—are you saying that when the amendments by Mr. Bush come in, those 82 programs that are eliminated by Mr. Reagan and for which there is a zero will be eliminated under the Bush amendments, and they will still be zero?

Mr. DARMAN. Until they are overtaken by either an executive branch agreement to substitute something or a congressional-administration agreement to substitute something, those will be what is on the table. But that said, could I make a second point?

Take for example the Appalachian Regional Commission, which I know you care quite a bit about, and which would, therefore, be

proposed initially at zero. We do not have the naive expectation that the end result of that program will be zero.

The CHAIRMAN. So will Mr. Bush's amendment put it back in?

Mr. DARMAN. His initial proposal will be at zero, but by the same token, what I am trying to say is, having lived through many years of having been criticized for being rigid on these points, we are this time attempting to be somewhat more realistic and flexible and say we would like to participate in the process of deliberating what alternatives there are to these proposals.

The CHAIRMAN. Well, you have not answered my question.

Mr. DARMAN. Senator, I believe I have.

The CHAIRMAN. The same thing can be said with reference to each of those 82 programs that are being eliminated.

Mr. DARMAN. Well, some of them we feel somewhat more strongly about, but none of them as strongly as the priorities. For example, in the area——

The CHAIRMAN. Well, those that you feel strongly about among the 82, will Mr. Bush's amendments put them back in, or continue to leave them zeroed out?

STATUS OF PROGRAM TERMINATION PROPOSALS

Mr. DARMAN. No, I mean feel strongly that the zeros are merited. In the case, for example, of education, the current Secretary of Education proposed to finance a set of initiatives by cutting 20 some odd of those 82 to zero on grounds that he believes have merit. He, therefore, will not be proposing to OMB and has not proposed to the President that those be changed from zero to another number, and not having done, those remain at zero.

Amtrak, for example—I know that this is also not universally appreciated—but in the case of Amtrak we feel that there is merit in cutting the subsidy, and we are leaving that at zero and feel somewhat more strongly about that. Others we feel somewhat less strongly about, but they will be at zero until there is something that overtakes them in the form of an agreement or an alternative proposal worked out within the administration.

The CHAIRMAN. Then what you are saying, if I hear you correctly, is, yes, Senator, those 82 items that have been eliminated by the Reagan budget are still eliminated as far as the Bush budget is concerned until such time as the Congress may decide that it does not want to go along with those and it puts them back in.

I am trying to help the members of this committee and your agency heads. Your agency heads when they come up before this committee—now you are talking about negotiations—we have got to have hearings. We cannot rush into negotiations without having hearings. When they come before this committee and try to respond to members' questions about Amtrak grants—let us look at the 82 programs—about Amtrak grants, about health professions training subsidies, about essential air service, about sewage treatment grants, about mass transit, about the 24 categorical education programs, and on down the list, they have been told in your memorandum that they are to accept the budget figures that have been submitted by Mr. Reagan until those budget figures are amended by Mr. Bush.

As of now, those budget figures are zero. So I am trying to get some understanding so that those agency heads, like Mr. Cavazos who could not explain the Education budget the other day, I am trying to get some explanation that will help them as well as us to know where we are on the 82 programs that are eliminated as well as on the items that are in the \$136 billion black hole.

Now here is what I see here. You referred to the current services approach as a wonderland approach, and I have agreed with you that it is not always the wise approach, depending upon the circumstances. A budget is a financial plan, that is, a dollar statement of priorities, that tells where the President's priorities are, and this administration has selected a few priorities, and it has shown down where it wants to. But that is selective leadership. It is not showing down on the blanks. It is not even showing down today on the 82 programs that Mr. Reagan has eliminated. That is selective leadership.

Mr. Bush says in this book here that that is what the President is for, is to lead. And he is not leading there. As to the Alice in Wonderland, Alice spent her whole time in chasing the white rabbit. Now we are spending our time in chasing a budget, chasing the figures, chasing the amendments that are to fill in the blanks.

So I am going to turn to Senator Hatfield after your response, if you care to respond, and hopefully we will be able to get some better understanding as to how the administration proposes to go forward with these items that are blanks and which we are left to believe that we should take the Reagan figures on which in turn means to me that the 82 programs eliminated by Mr. Reagan are also eliminated by Mr. Bush.

SETTING PRIORITIES

Mr. DARMAN. I would ask that I be able to comment briefly, Mr. Chairman. I think that leadership in the selection of priorities is necessarily selective. So it does not strike me as a criticism to say that it is selective. It is inherently selective. The President has said what he takes to be the important areas, that he would prefer to see increases in. He knows at the same time that every member of this committee will have a different personal set of priorities, and I think to say that he is prepared to negotiate at some point should not be viewed as something to be criticized. At some point it should be viewed as something positive.

The CHAIRMAN. I agree with that at some point.

Mr. DARMAN. OK. [Laughter.]

I recognize we are not yet at that point, but I am glad to know it may come. Second, I would respectfully suggest that while it is understandable that some would have characterized the \$136 billion as in a black hole on day one when the 193 page document came out, I do think that we are well ahead of that at the moment. We now have at the program level, account, subaccount level, every level you could ask for, cut every way one could, the numbers for every single thing in that \$136 billion. And so, sir, I would respectfully suggest that these are not blanks, and that the program is now that we have said that to start the process, since you all did

not like our providing option one, option two, and option three, you said pick one, you've got to start somewhere.

The CHAIRMAN. That is right. That is like a Chinese menu. Take egg-rolls from this list and take bomb over Tokyo soup from that list, and take sweet and sour sauce from that list.

Mr. DARMAN. That is how you end up with a good meal. [Laughter.]

The CHAIRMAN. You get the sweet and we get the sour. [Laughter.]

Mr. DARMAN. Maybe I should stop at that point, sir, but that is not the intention. That is definitely not the intention.

The CHAIRMAN. Well, we have made some progress, Mr. Darman, and I want to thank you for that. You are in a tough spot. We are in a tough spot. I do not envy you in your spot, and I think you are trying your very level best to be loyal to your chief, and if I were in your position, I would be doing that, too.

Mr. DARMAN. Thank you, sir.

The CHAIRMAN. Mr. Hatfield.

SENATOR HATFIELD'S OPENING REMARKS

Senator HATFIELD. Mr. Chairman, I cannot help but think back in history to 1981 when I was chairing this committee, having received the last of the Carter budgets, and having received the first of Reagan's. I would agree with the chairman that the sooner we can get these specific amendments, the better it will be for the process.

But I would also observe that the first reaction that we had from the Reagan budget proposal in 1981 was a sense of authoritarianism that the President set the budget and the priorities, and the Congress was merely to ratify the President's request. There is a great distinction this year, and I commend you, Mr. Darman. I feel that in spite of the frustration that I share with the chairman, I think that frustration is more with the process that we are forced into rather than the attitude of the administration.

I find the attitude of this administration much more open, much more willing to incorporate and recognize the legitimate role of the Congress in making determinations, not in an effort to avoid responsibility in the White House, but rather to share that responsibility with the Congress.

I must say to our chairman as I indicate my agreement with him, if I had to choose between the two styles, I would welcome this style far more than that attitude bordering on arrogance with which the administration presented its first budget in 1981. That attitude said here it is, do not do any thinking, do not do any changing, just adopt it as we have given it to you.

I remember the rousing protests that went up in 1981 reminding the Director, Mr. Stockman, that we had some say in these matters, and we expected to exercise them.

A NEW BREEZE BLOWING IN EXECUTIVE-CONGRESSIONAL RELATIONS

The CHAIRMAN. I agree with that, Mr. Hatfield, and as I said following the election of President Bush, as against his predecessor, I think we have a new breeze blowing, and it is good that we have

that, and he has indicated his desire to work in a bipartisan way. He is a creature of the Congress. He understands the legislative branch, and I think he understands, which his predecessor apparently never did, that there is a system of checks and balances under this constitution, and I think Mr. Bush understands that.

He has extended the hand in cooperation. This Senator wants to cooperate. This Senator wants to work with this President and will work with him because the final product has to be a bipartisan product. But we need the tools to work with, and we do need to fill in the blanks. That is what I am trying to get done. And that does not come out of your time.

NUCLEAR ENERGY CLEANUP

Senator HATFIELD. I thank the chairman. Not only bipartisan, Mr. Chairman, but two-branch effort. Yesterday, Mr. Darman, three Federal agencies—the EPA, the DOE, and the Justice Department—entered into and finalized a joint agreement with the Governor of Washington State and the Governor of Oregon in relation to the cleanup at Hanford.

This was similar to other agreements reached in other States. However, this one was by agreement and not by some consent decree issued by a judge. In this agreement, they recognize a 30-year requirement to make this cleanup, and in it they also say that the DOE should seek a \$2.8 million annual appropriation for the next 5 years to start this cleanup.

Unlike other agreements, as I say, this one was reached in good faith amongst all the parties without going to court. My question to you, Mr. Darman, is now that these agencies and the States have reached this agreement, will you honor the request that DOE will make to you for this next period of time of at least \$2.8 million annually to begin this cleanup, because as you know, about half of the Nation's waste is in this one location?

It is estimated that about \$45 billion to \$50 billion will be required ultimately out of the estimated \$100 billion national clean-up program.

Mr. DARMAN. Thank you, Senator Hatfield, for your introductory comments, and with respect to your question, did I hear you say \$2.8 million or billion?

Senator HATFIELD. Billion. I am sorry.

Mr. DARMAN. Billion. If it is \$2.8 billion, it is my understanding that that is a 5 year cost and not an initial—

Senator HATFIELD. Yes.

Mr. DARMAN [continuing]. Annual cost. That that is the amount that they expect to be expended for the total of the first 5 years, and if that is correct, I would say that it is not out of line with what we had been expecting when we put our budget proposal together.

It is initially consistent with what we requested be appropriated for 1990. In the out-years, if it were generalized to all of the cases, it would probably result in a number higher than we have budgeted. But we expected that as a possibility, and so I would say we will have to look at the details of the agreement. I did not know of

this agreement in advance. I learned of it reading The Washington Post this morning and so I obviously have not seen the detail.

But assuming that the detail justifies the costs, the costs are not out of line with what we were expecting to be associated with this cleanup.

Senator HATFIELD. For the record, would you put a high priority on checking through that agreement as quickly as possible so we may incorporate your response in a definitive way for this particular fiscal year which we are working on?

Mr. DARMAN. Yes, I would, Senator Hatfield.

Senator HATFIELD. And also, while I have no wish to raise this as a threat or as a club, there is enforceability of this agreement and penalty provisions; therefore, I would urge you to look at it carefully to get your kind of support as I believe it is better to utilize the money for cleanup than to pay attorneys. I think it is a better return on the dollar.

I think also that we have to link this cleanup to the so-called attempt to locate new production reactors, particularly in South Carolina and Idaho. There is a program afoot because of the ancient reactors which we have to deal with which are not effective. I would suggest, Mr. Darman, that I see a link between the growing unexpected resistance in some of these areas from citizen groups and the way in which the Federal Government will handle the cleanup in existing reactor locations.

I do not think it is to the benefit of the replacement program to fail to live up to such agreements as has occurred both by court order and by this voluntary agreement of the Northwest. Would you not agree that there is perhaps a link between these proposed and existing actions?

Mr. DARMAN. I think that you would be better judges because I think the nature of the linkage is political. But my own amateur judgment would be that, yes, there is a linkage. To the extent that we are able to persuade people that we are responsible in addressing the cleanup issues, they will have more confidence in us when we attempt to persuade them that certain kinds of production are also safe. That would be my judgment.

I may say that is one of the reasons that we reversed the prior OMB decision and increased the investment in cleanup.

LIFTING BAN ON EXPORT OF LOGS

Senator HATFIELD. Mr. Darman, we have another part of your budget that is looking for a revenue source from lifting the ban on the export of logs from Federal forest lands. In the joint budget of Mr. Reagan and Mr. Bush, it is estimated between \$75 million and \$100 million could come into the Treasury as a result of lifting this ban on export of logs. Yet the CBO indicates that it would possibly be \$7 million a year.

My question is do you have the database upon which an analysis was made on how much revenues would be received from the sale of logs from Federal forest lands? If you have, I would like to have you submit that analysis to the committee to help us understand why there is this large differential in the estimates of revenues between the CBO and the OMB.

Also, do you have an analysis on the economic impact of that kind of sale off of Federal lands, and what kind of economic impact vis-a-vis jobs, taxes, et cetera, exists on the Northwest region where this ban has been placed?

Mr. DARMAN. Senator, I do not personally have the database with me. I will be happy to find out what it was based on and to provide that to you and attempt to analyze any discrepancy between our own analysis and CBO's. I have not seen such an analysis. I was aware of ours being on the order of 75 to 100. I was not aware that CBO's was as low as you suggest.

I have to confess that this was one item that did not get formal and detailed review as we came in and attempted to put all this together by February 9. As you know, it is hidden in a revenue estimate along with hundreds and hundreds and hundreds of other assumptions, and so I did not specifically look at the issue of any associated economic dislocation.

In fact, in the cursory way that I did look at it, I looked only at what I thought would be the export benefit and was not at the time aware of the possible dislocation for millers in your region, about which I have since learned.

Senator HATFIELD. Please do include it in the database, too—the impact on the local economy.

Mr. DARMAN. I will take a look at that. Yes, sir.

BONNEVILLE POWER ADMINISTRATION

Senator HATFIELD. I have one last question. You have continued the recommendation that Mr. Reagan's budget had, and that was to increase by \$500 million the repayment schedule of the Bonneville Power Administration. This is \$500 million over and above the \$600 million that is being used in the current schedule, which would be about a billion, a little in excess of a billion.

Again, I am asking for any database that developed this recommendation, any database on the impact it would have such as increasing the power rates to the Northwest by about 25 or 30 percent. What kind of economic impact it would have on the center of aluminum production in this country, as direct users of Bonneville power.

I would like that database as well. I have said to you before, Mr. Darman, and I only repeat now for the record, under no circumstances can either one of these proposals be acceptable to us—I speak for myself and for my colleagues from the Northwest involved in the Bonneville power program—because our economy is not sufficiently strong to sustain that kind of impact. But by the same token, I am curious to know whether or not in the whole field of natural resources, will we see a change in the Bush administration? I am convinced that the Reagan administration, while looking at natural resources, the land, and the economy of the western part of the country where great public ownership exists, looked at those resources more as policies driven by budgetary rather than sound land management policies.

Since President Bush has made such a very strong and very good point about the environment and about our natural resources, I would like to see some clear indication that these resources are

going to be managed more by sound natural resource policies than being viewed as purely something to sell off or something to use for reducing the deficit.

They can play a dual role here. There are those that do produce revenues. But by the same token, the revenues only succeed upon a sound base of administrative policy, not as a budgetary base. So I would like to have that database, and also any further indication of a shift in the way this administration views those great public land resources in the West.

Mr. DARMAN. Thank you, Senator. On the specific case of Bonneville, I am aware of an outside study that suggested that the rate increase might be in the area of 30 to 35 percent. I believe our internal analysis said it was more on the order of 20 percent. I will in the same way as in the prior question attempt to provide you with both our own basis for analysis and any reconciliation of the differences.

I might just say, however, that the perspective that was brought to bear on this, I would not describe as strictly as budgetary. It is perhaps a small point, but I think of it more as a matter of fairness. The original financing system for this and the other power marketing administrations was set up basically in the depression on extremely favorable terms at very low interest rates. These are now healthy going concerns, and our argument to ourselves was, as it has been before, and it has never been well received, I know, but the argument that 2 percent interest rates in terms of the cost of borrowing in today's world are awfully favorable terms, justified in the depression, but it is not entirely clear what would justify them in today's world.

It is more that that drove this than the budgetary matter pure and simple.

Senator HATFIELD. Mr. Darman, I will take that up with you again on future occasion and ask, if necessary, for a special hearing. I would only say that we have been in a depression in the State of Oregon, and to a lesser degree in other parts of the Northwest. We are just now getting out of that depression, and we do not want to go back into it. So rates do relate to current depressions as well as to the Great Depression.

Mr. Chairman, I would ask unanimous consent that further questions I have for myself and for Senators D'Amato and Grassley might be submitted to Mr. Darman for the record.

The CHAIRMAN. Very well. Without objection, the questions will be submitted for the record, and the committee will appreciate your responses, Mr. Darman.

Mr. Inouye.

DEFENSE OUTLAY ESTIMATES

Senator INOUE. Thank you very much, Mr. Chairman. I hope you will forgive my voice. CBO and OMB differ in defense outlay estimates for fiscal year 1990 by \$3.4 billion, which incidentally is greater than the total reduction proposed by the President for defense.

My question is why this difference and what is the significance?

Mr. DARMAN. Thank you, Senator. I believe you are correct about the difference in the estimate. It basically has to do with the difference in the assumption about the spend-out rate, and OMB staff and CBO met yesterday for about 4 hours on this issue trying to resolve the difference. It is at a level of detail that I do not have here with me.

I would hope we could close the gap between us because as I see it, it is a strictly technical difference at the moment in terms of assumptions about the spend-out rates for programs already committed and assumptions about what is in the mix for the new budget authority. When you look at a table of the past record of both ourselves and CBO in forecasting, the standard error of the administration is 1.6 percent and the standard error of CBO is 1.3 percent. It seems to me we ought to both recognize that we could be wrong, and somehow or other resolve the differences here and not let it be a technical debate forever. I agree with you that it is a little bit awkward to be in a position where we have a \$3.5 billion difference that is strictly a function of a difference in technical estimating. So we are trying to resolve that.

Senator INOUE. I ask this question because in past years the Budget Committee has informed us to adhere to CBO scorekeeping instead of OMB, and so therefore, it becomes very important to us.

Mr. DARMAN. And to us.

Senator INOUE. What is the rationale for giving inflationary protection to defense outlays but not to discretionary domestic spending?

Mr. DARMAN. First of all, Senator, I might note that some discretionary spending gets much more than an inflation adjustment. Of the amount of nondefense discretionary spending that is in the \$136 billion piece, about \$6 billion of that is defense, and about \$10 billion of it is in mandatory programs. So there is only \$120 billion that is nondefense discretionary, and that portion is frozen at the nominal level by hypothesis on paper.

The total nondefense discretionary portion of the Bush budget is about \$182 billion. The part that is not in the \$120 billion, that is not in the so-called black box, that part is going up substantially faster than inflation, and indeed, the nondefense discretionary programs taken as a whole increase at about 2.9 percent, fairly close to the inflation rate. But to answer your question, these were not analyzed on a basis that said we should have a common policy for the two.

The defense number was independently arrived at after an extensive and relatively normal debate between the Department of Defense and OMB and other interested parties. The number that was settled upon for defense was one which the President took to be the appropriate level in view of his sense of defense needs: The foreign policy implications of cutting defense any lower than zero real growth in a context where we were asking others to increase burden-sharing, a number of other considerations of that kind, not exclusively budgetary, although also budgetary, that led to the defense number. It was calculated independently of the domestic discretionary number.

IMPACT OF DEFENSE FREEZE

Senator INOUE. What is your reaction to freezing the defense level at the 1989 level?

Mr. DARMAN. Well, it would only save \$1.4 billion in our estimate in outlays. So it is not a significant amount of money on the outlay side. It is a significant amount, however, in budget authority and would have effect in the future years on program in a way that the Defense Department judges to be adverse.

As you know, the President directed that there be a 60-day study of how Defense could adjust its 5-year plan from the 2 percent real growth that they had been using downward by \$30 billion in outlays and \$44 billion in budget authority for 4 years to meet the new Bush targets. They are in the process of doing that review at the moment. I would be very surprised if they were to conclude that it would be easy to find another \$1.4 billion in outlays.

INDIAN MUSEUM FUNDING

Senator INOUE. I have many other questions, Mr. Chairman, but I would like to save my voice. But finally may I ask a small question. I am chairman of the Indian Affairs Committee, and I was pleased to learn that your office will favorably consider an appropriation of \$5 million for planning and design moneys for the museum. Is that correct?

Mr. DARMAN. I'd be happy to take credit for it, but I must confess I was not aware of it. Why do you not assume in advance that in the spirit of comity we will work this out, but it has not come to me. I apologize. Let me just quickly check and see if by chance someone else can verify that I indeed deserve credit for this.

I am pleased to report that I worked on this all last night, Senator. [Laughter.]

Senator INOUE. I thank you again, sir. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Stevens.

PROPOSED PROGRAM TERMINATIONS

Senator STEVENS. Thank you very much, Mr. Chairman. I am delighted to see my old friend here on his solo trip to present the position of the President. While I have great love and affection for my friend, the distinguished President pro tempore of the Senate, in my time here and in this committee with him, I have seen Presidents zero out so many things that it has become less of a concern. The Public Law 874 moneys, I think, have been reduced by every President since Harry Truman and been restored by every Congress. And I am sure we intend to do again this year, and I am sure you know we intend to do so.

So I would like to get down to some of the problem areas. One of them is one of those areas, and incidentally, if I am not mistaken, most of them are congressional add-ons that you just zero out automatically because you know we are going to go put them back in; is that not right?

Mr. DARMAN. I would not say it is because we know you are going to put them back in. Hope springs eternal in the executive branch, Senator.

Senator STEVENS. I think you almost rely on us putting them back in. For instance—

Mr. DARMAN. I remember first proposing to eliminate impact aid in education when I was in charge of planning and budgeting in HEW back in 1970. The success ratio is not too high.

Senator STEVENS. And necessarily so, I assume. But essential air service, now that is an interesting program that was started by my good friend, the former Senator from Nevada, Senator Cannon, and I, to meet a specific problem in Alaska at the time of deregulation. It has now become a national program because it meets a great need. Yet that has not been funded. Do I understand that there has been a change in position on that now?

Mr. DARMAN. Well, the Secretary of Transportation, I think, has talked with many of you who have a strong interest in this, and he is looking at the possibility of trying to find offsets and coming up with a way to fund that, I believe, but he has not yet submitted his proposal to OMB. He has simply alerted me to the fact that he is looking at that and would expect at some point, I think, to have a proposal.

POSTAL SERVICE—ON OR OFF BUDGET?

Senator STEVENS. All right. We will await that. When we visited, I did discuss with you one of my favorite subjects, and that is taking the postal service back off budget. It was not on budget when it was originally created following the demise of the old Post Office Department.

I think by mistake actually it was put on budget. Then in 1987 we had a traumatic occasion when we were forced to reduce capital expenditures to the Postal Service in order to balance the operating budget of the Federal Government. This year, as I understand it, and I submitted a memorandum to you on this issue, but this year is the one year if it went off-budget, it would not have a traumatic effect on future budgets. I think we could adjust the budget so the Postal Service could once again become an independent arm of the Government. It should be allowed to borrow money and make expenditures to meet the demands of its customers and to be able to literally provide the service that is required by the constitution.

We are required, you know, to maintain post offices by the constitution. I do not think we can do it and keep the Postal Service on budget. Can you just tell me when do you think you might be able to give us your opinion in that regard?

Mr. DARMAN. Thank you, Senator. I recall our conversation very well, and I can assure you that many times in the process of trying to put together the February 9 budget, I was tempted to accept your suggestion immediately because it would have a favorable effect in the short-term on the budget, as we all know.

But it is still under review within OMB. As you can imagine, I have been indoctrinated by people of a contrary school on this. My own position at the moment is teetering somewhere in the middle,

looking for ways to possibly refine a proposal that might be able to move it off-budget, but at the same time cap the Federal Government's liability, and that is where I think we would run into some probable disagreement.

What worries me about just moving it off-budget as is without some protection against limitless Federal exposure is just that, that we need to have some protection against the continuing rise of the Federal exposure. But assuming that we can work out some way to address that issue—that is the one that it is hung up on in my own mind, at the moment at least—I have some positive interest in looking in that direction.

Senator STEVENS. I hope so, and I look forward to being able to work with you on that. I do think that the real difficulty is that this Postal Service has to be able to move into new technology. It has to be able to move into new innovations such as the overnight delivery of mail with its own chartered fleet, and I think those considerations have to be made in a business climate, not in the climate of meeting Gramm-Rudman-Hollings.

If they can show that they can pay off the debt with their initiatives, they ought to be able to continue to be an independent arm of the Government. If not, the time is going to come, not too far away, when we will be faced with substantial costs back on the budget if it stays on the budget.

DEFENSE BUDGET PLANNING

Last, in the defense area, I noted the comments that the President has made and that have been made on his behalf, and of course, I am one who believes that the country would be considerably better off if John Tower would be Secretary of Defense because I think he understands the problem, and he has stated that we have to get more for less out of defense.

But even with that, I just heard something I was not sure I understood, and that was your comment to Senator Inouye about the extent to which the 5-year plan will be modified now. Are we to await that before we consider this year's budget?

Mr. DARMAN. No, we have a two- or three-track system going in defense at the moment on these different studies. They all date from February 9. One of them was a 60-day study to determine as quickly as possible within those 60 days what program adjustments or other adjustments would have to be made in order to meet the fiscal year 1990 target. I would hope we could have that relatively quickly for fiscal year 1990.

On a separate track are two longer term studies, one by the Secretary of Defense and one by the National Security Council dealing with the larger issues of strategy, longer term management, and the interrelationship of foreign policy and defense force structure and all of these larger issues. Those are separable from the fiscal year 1990 budget issue.

Those studies are due, I believe, in 90 days from February 9. The results of those for the out years would not be available until whatever that is, roughly another 2 months, and much sooner, I would hope, for fiscal year 1990.

Senator STEVENS. In the procurement area, long lead-time items that are in this budget, as I understand it, would be affected by those changes. I hope that we can at least get some idea about these effects. I hope you will address those items that would be affected by this budget first in that long-term review of the Department of Defense.

Otherwise, we could well be funding long-range procurement items for items that would no longer be in the 5-year plan. I know there is an adjustment that is going to take place here, and reality is reality. It will take place. But I would like to be as accurate in terms of its guesstimates as possible.

Mr. DARMAN. You are right that they are intellectually linked, but one of them just is a much harder problem intellectually, and so it is going to take a little bit longer. Indeed, I do not know if it can be done right in 90 days.

Senator STEVENS. Thank you very much. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Stevens.

- Senator Johnston.

NUCLEAR WASTE CLEANUP

Senator JOHNSTON. Thank you, Mr. Chairman. Mr. Darman, I do not want to sound a negative note on what apparently is progress on a very daunting challenge, that is nuclear waste cleanup. But I was amazed to read in the paper this morning about an agreement confected that apparently is coupled with enforceability creating what seems to be a new entitlement on nuclear waste. We in the committee, I do not think, Energy Committee, and other committees, have not authorized that, have not even been told that there is a specific plan involving specific technology for doing this, and I just wonder. I mean \$55 billion is the figure that has been used. I do not know that that has got a basis to figure \$55 billion as the real cost. But I mean I just wonder if some bureaucrat is going out and creating entitlements without congressional action and oversight, without a national plan—I mean I wonder how the people in Fernald, ID, and Rocky Flats and other places feel about someone else being put in ahead of them.

I do not criticize the agreement. I do not know anything about the agreement, and I, for one, have been on the side of Senator Adams and others who have been saying we needed to do more in the past. But this question of entitlement, I think, is a serious one. I just commend that to your study. I know you probably just read about it this morning, and I do not ask for an answer on that, but I think you should look at it because it is an enormously expensive problem that may be coming up.

Mr. DARMAN. I agree with you, Senator. I had the same reaction when I read the newspaper, and I did not say so to Senator Hatfield only in the interest of time. But I was concerned, based on the newspaper account, about what looked like an open-ended liability possibility for the Government. We will have to look at that.

Senator JOHNSTON. I mean it is our responsibility. I do not in any way suggest that we do not need a very high degree of commitment

to that. Maybe the money is too little. Maybe it is too much. But it is the idea of somebody creating an entitlement without authority.

Senator ADAMS. Would the Senator yield? I do not want to take his time, but I was at that conference, and I would state to the Senator and to the Director of OMB, it is not an entitlement program. It is subject to the appropriation process.

Senator JOHNSTON. I understand, though, that it creates an enforceability if money is not——

Senator ADAMS. There are enforceability provisions in it, but I will discuss those on my own time, and I thank the Senator for yielding.

OMB-CBO BUDGET ESTIMATES

Senator JOHNSTON. Thank you. Mr. Darman, to try to define what the scope of the difference is between some of us and the Bush budget, I understand that CBO and OMB have a \$10 billion discrepancy. I understand that you think OMB is better. Is that about right?

Mr. DARMAN. On the overall Bush budget?

Senator JOHNSTON. Yes.

Mr. DARMAN. We do not have——

Senator JOHNSTON. On economic assumptions.

Mr. DARMAN. We do not have a CBO reestimate of our budget. We only have—I will double check this—but I only have CBO reestimate of the Reagan budget. That is correct. We do not yet have it. But we have adjusted our economic assumptions slightly so they should be a little bit closer to us than they were with Reagan. But you are right. It is \$10.2 billion total on economics. That is between CBO and Reagan.

Senator JOHNSTON. Yes.

Mr. DARMAN. It should be a little smaller between CBO and Bush because we raised——

Senator JOHNSTON. Because interest rates look worse since Bush came in. But in any event, I have the——

Mr. DARMAN. But they have not yet changed their assumptions.

Senator JOHNSTON. On technical readjustments, it is about \$17 billion difference?

Mr. DARMAN. That is right.

Senator JOHNSTON. Then we have \$10 billion in the black box?

Mr. DARMAN. Well, it is \$9.6 billion, but I do not consider any of that to be an issue of estimating.

Senator JOHNSTON. Oh, I understand that. I am just trying to figure out how far off we are.

Mr. DARMAN. We could be zero.

Senator JOHNSTON. If you do not accept your technical readjustments and economics and you do not include the black box, we are about \$37 billion difference in outlays.

Mr. DARMAN. Except that, Senator, I think, for example, of the technicals that you mentioned, \$11 billion alone is related to our savings and loan sector proposals which CBO did not have at the time that they estimated. Now that they have them, I think they will move our way by a substantial amount, just under that head-

ing. On the black box, that is not an estimating difference of any kind.

MEDICARE PROPOSALS

Senator JOHNSTON. I know it is not estimating. Now you have got your \$5 billion cut in Medicare; that is not in the black box.

Mr. DARMAN. No.

Senator JOHNSTON. OK. Do you have a proposal for the \$5 billion or just illustrative ways in which that could be saved?

Mr. DARMAN. Well, we have a set of proposals that are the starting position. CBO has a set that actually totals \$6 billion. Ours only total \$5 billion, but ours is a starting point.

Senator JOHNSTON. Are those illustrative options or do you have a specific?

Mr. DARMAN. No, they are our preferred options.

Senator JOHNSTON. Preferred options?

Mr. DARMAN. Yes.

Senator JOHNSTON. OK.

Mr. DARMAN. Would you like me to state what they are?

Senator JOHNSTON. Yes.

Mr. DARMAN. Well, as I mentioned in my testimony—I think it may have been before you were here, Senator Johnson—\$2 billion alone of that \$5 billion is getting rid of some gimmickry and just extending the existing provisions for capital cost reimbursement at 85 percent.

Senator JOHNSTON. That is, in effect, paid by the hospitals?

Mr. DARMAN. It is today, and if we just continue to reimburse at 85 percent.

Senator JOHNSTON. Well, the question is not whether it is right or wrong, but who pays. That is \$2 billion. That is real money. It may be a technical readjustment or readjustment, but it is \$2 billion that the hospitals would pay.

Mr. DARMAN. Well, actually that provision is \$930 million. That one is about a billion dollars, just keeping it as is. Of the \$5 billion we would quote "save" a billion dollars just by keeping the existing capital reimbursement system at 85 percent.

Then if we kept the existing premium floor at 25 percent, we would save another \$720 million roughly.

Senator JOHNSTON. That is to be paid by the——

Mr. DARMAN. Beneficiary.

Senator JOHNSTON. Beneficiary.

Mr. DARMAN. That is about \$714 million on our estimate. That is too accurate to be——

Senator JOHNSTON. Do you know how much a month we are talking about on average?

Mr. DARMAN. Yes, it would be, if we did not extend it, the difference would be about 70 cents a month.

Senator JOHNSTON. On average.

Mr. DARMAN. Less than a dollar, on average. Yes, sir. And then clinical laboratory payment rules, the provision of current law, if it were just extended, that would be another quote "saving" of \$200 million. So the combination of those is almost \$2 billion in savings out of the \$5 billion that would come from just doing——

Senator JOHNSTON. And where is the other \$3 billion?

Mr. DARMAN. The other \$3 billion come from a variety of changes. One of them is to reduce the indirect medical education reimbursement add-on to 4.05 percent as opposed to the 7.7 percent, which is what GAO has recommended. That would save over \$1 billion just doing what GAO and an outside group called ProPAC have recommended as being the appropriate reimbursement rate there.

Senator JOHNSTON. Well, I tell you what. I will get those from you.

Mr. DARMAN. I will be happy to submit them.

[The information follows:]

SUMMARY OF PROPOSED MEDICARE BUDGET AMENDMENTS OF 1989

Section 1 would assign the draft bill the short title "Medicare Budget Amendments of 1989".

Section 2 would require that all State and local government employees (rather than only those hired after March 1986) contribute to the Medicare Federal Hospital Insurance (HI) Trust Fund. Previous years of State or local government service would be counted in determining eligibility for Medicare benefits. Under this proposal State and local employees, most of whom will receive Medicare benefits due to other employment, would contribute their fair share to the HI Trust Fund, and Medicare coverage would be provided to some persons ineligible under current law.

Section 3 would permanently establish the Supplementary Medical Insurance (SMI) non-catastrophic premium at 25 percent of the estimated SMI non-catastrophic program per capita costs for the aged. Under current law, the monthly non-catastrophic premium for 1989 is set at 25 percent of the estimated non-catastrophic program per capita costs for the aged; annual increases in the monthly non-catastrophic premium for later years are to be limited by the percentage increase in Social Security benefits. The proposal would continue a more reasonable balance between Federal and beneficiary shares of total program costs, which were originally intended to be evenly shared.

Current law requires that hospitals under the diagnosis related group (DRG) system be paid additional amounts for the indirect costs of medical education on a curvilinear formula that provides for an 7.65% adjustment through fiscal year 1995, and 8.29% thereafter, for a .1 ratio of interns and residents to beds. Section 4 would reduce the factor to 4.05% for fiscal year 1990 and thereafter. This proposal would result in payments that more accurately reflect the estimated effect of teaching programs on average operating costs. Both the Inspector General of the Department of Health and Human Services and the Comptroller General have recommended reductions in this area.

Medicare makes special payments to hospitals for the direct costs of medical education, including salaries and fringe benefits, appropriately allocated overhead, and classroom and other educational program activities for residents. Section 5 would restrict payments for residents to cover only the costs of residents' salaries and fringe benefits and appropriately allocated overhead, and would change the base period for calculating the payments from fiscal year 1984 to the period July 1985 through June 1986, the first period for which the necessary data are available. The current payment system has resulted in extreme variations in per resident amounts, leading to distorted payments among hospitals.

Section 6 would set the hospital payments update factor for all hospitals (whether or not under the prospective payment system) for fiscal year 1990 at the market basket percentage increase less 1.5 percentage points. This proposal would assist in reducing the deficit and would maintain incentives for hospitals to restrain the rate of growth in costs.

Section 7 would reduce Medicare payments for capital-related costs by 25 percent for fiscal year 1990 and later fiscal years. Under current law, the reductions in capital-related costs in effect since fiscal year 1987 will expire after fiscal year 1989. Hospital capital costs in Medicare are paid under an inflationary cost reimbursement system rather than on a prospective basis, as is done for operating costs. In addition, the present rules of

capital reimbursement will increase future operating costs because, historically, capital costs have been shown to increase future operating costs in the hospital industry as a whole. Further, the current Medicare rules for reimbursing capital costs perpetuate excessive overbedding. The average occupancy rate for the hospital industry is at an historical low of 65 percent and declining.

Section 8 would limit the percentage increase in the Medicare Economic Index for physicians' services to 0 percent for 1990, and 1 percent for each of the years 1991 and 1992, but primary care services would continue to receive a full increase. This proposal would assist in constraining spending while narrowing the difference between payments for primary and non-primary services.

Section 9 would reduce by 12 percent in 1990 the prevailing charges for overpriced procedures (specified in current law). Reductions made in 1988 have not sufficiently compensated for overpricing.

Section 10 would reduce by 8 percent in 1990 the prevailing charges (and the fee schedule amounts, as applicable) for radiology services, anesthesia services, and surgical procedures. These services and procedures are currently overpriced in comparison with other physicians' services.

Current law limits Medicare payments to new physicians to 80 percent of prevailing charges during the initial period for which adequate actual charge data are not available to set a customary charge. Section 11 would apply the limits to the payment levels for the subsequent three years of a new physician's practice, but would raise the limits to 85, 90, and then 95 percent of prevailing charges. The section would also apply the limits to radiologists, who are paid on a fee schedule rather than reasonable charge basis. This proposal would explicitly incorporate the effect of gradual acquisition of professional experience into Medicare payment policy.

Medicare pays anesthesiologists for their medical direction of nurse anesthetists on the basis of the sum of "base units" and "time units." Current law provides for reductions in the number of base units when more than one nurse anesthetist is directed concurrently. Section 12 would modify current law by --

subjecting time units, as well as base units, to reductions,

making the reductions permanent (under current law, the reductions expire after 1990),

increasing the reductions from 10 to 30 percent for direction of 2 nurse anesthetists (and more than 2 in case of cataract surgery or an iridectomy procedure),

increasing the reductions from 25 to 40 percent for direction of 3 nurse anesthetists, and

increasing the reductions from 40 to 50 percent for direction of 4 nurse anesthetists.

There is little rationale for applying limits solely to base units, as both time and base units are integral parts of the payment system. Increasing and making permanent the reductions would assist in restraining excessive costs.

Section 13 would place a limit on the prevailing charge for procedures designated by the Secretary for which the prevailing

charge is different for different physician specialties. The limit would be the prevailing charge (or fee schedule amount) for that specialty that performs the procedure most frequently nationally. This proposal would assist in restraining unnecessary costs.

Under current law, a Medicare beneficiary with end stage renal disease (ESRD) may arrange for home dialysis in one of two ways: all services, equipment and supplies may be provided by a renal dialysis facility (or hospital), in which case assignment must be accepted and payment is based on composite rates per treatment specified by the Secretary; or equipment and supplies may be purchased separately from one or more suppliers, but payment for these is not subject to the composite rates, nor is assignment required. Section 14 would permit a supplier to furnish equipment and supplies only if the supplier agreed to furnish for a specified period of time all needed supplies and equipment, and agreed to accept assignment; and only if a renal dialysis facility (or hospital) agreed to furnish all self-care dialysis support services and (if needed) institutional dialysis services and supplies. Monthly payments for the supplies and equipment could not exceed the weighted national average of the composite rates per treatment multiplied by the national average number of treatments per beneficiary per month. The section would also eliminate obsolete language concerning target rates. This proposal would eliminate an anomaly in the Medicare payment structure that permits suppliers in certain circumstances to obtain excessive payments.

Section 15 would make a number of changes concerning "other" durable medical equipment (primarily hospital beds and wheelchairs):

The fee schedule for 1990 and future years would be based on reasonable, rather than submitted, charges.

Items could be purchased on a lump sum or lease-purchase basis, as an alternative to rental.

15 months of payments (each at 10 percent of the lump sum purchase price) would be allowed for lease-purchase (after which title would pass to the beneficiary); only 12 months of payments would be permitted for rental.

These provisions would eliminate grossly inflated payment rates and would enhance beneficiary choice.

Section 16 would reduce by 5 percent the payment rates for oxygen and oxygen equipment in 1990. Payment levels in this area are excessive.

Section 17 would limit payments for enteral nutrition nutrients and supplies, and for parenteral and enteral nutrition equipment, by a fee schedule to be developed by the Secretary (based on appropriate price information). The fee schedule would take effect in 1990 and would increase in future years by the percent increase in the consumer price index. Payments for equipment would be subject to the rules for durable medical equipment (DME) (intravenous poles would fall under the inexpensive DME category, while infusion pumps would be fall under the "other DME items" category). Current payment levels are excessive.

Under current law, a national fee schedule for clinical diagnostic laboratory tests is to take effect in 1990. Section 18 would eliminate the national fee schedule. Instead, the current system of carrier-wide fee schedules, subject to an upper limit of the national median fee schedule amount for each test,

would be made permanent. A national fee schedule, which would no longer be subject to the current median limits, would significantly increase payments. These increases cannot be justified, particularly during this period of critical need for budgetary restraint.

A B I L L

To reduce costs in the Medicare program, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled.

SHORT TITLE AND REFERENCES IN ACT

Section 1. (a) This Act may be cited as the "Medicare Budget Amendments of 1989".

(b) The amendments in this Act apply to the Social Security Act unless otherwise specifically stated.

COVERAGE OF ALL STATE AND LOCAL GOVERNMENT EMPLOYEES

Sec. 2. (a) Section 3121(u)(2) of the Internal Revenue Code of 1986 is amended --

(1) in subparagraph (A), by striking out "subparagraphs (B) and (C)" and inserting instead "subparagraph (B)", and

(2) by striking out subparagraphs (C) and (D).

(b) Section 210(p) is amended --

(1) in paragraph (1)(B), by striking out "paragraphs (2) and (3)" and inserting instead "paragraph (2)", and

(2) by striking out paragraphs (3) and (4).

(c) Section 218(n) is repealed.

(d)(1) The amendments made by subsection (a) apply to remuneration paid after September 1989.

(2) The amendments made by subsections (b) and (c) are effective as of October 1, 1989 (and, except as provided in paragraph (3), the amendments made by subsection (b) apply only to employment for which remuneration is paid after September 1989).

(3) If any portion of an individual's employment during

October 1989 is medicare qualified government employment (as defined in section 210(p) of the Social Security Act as amended by subsection (b) of this section), then the amendments made by subsection (b) of this section apply to all periods (if any) of that individual's medicare qualified government employment (as so defined) before October 1989.

(4) For purposes of establishing entitlement to hospital insurance benefits under part A of title XVIII of the Social Security Act pursuant to the amendments made by subsection (b), no individual may be considered to be under a disability for any period before October 1989.

(e) Section 278(d)(2)(A) of the Tax Equity and Fiscal Responsibility Act of 1982 is amended by inserting "or of section 2(d)(3) of the Medicare Budget Amendments of 1989" after "subsection".

SUPPLEMENTARY MEDICAL INSURANCE PREMIUM

Sec. 3. (a)(1)(A) Section 1839(a)(2) is amended by striking out ", (e),".

(B) The matter between the first and last sentences of section 1839(a)(3) is amended to read as follows: "The monthly premium shall (except as otherwise provided in subsection (g)) be equal to 50 percent of the monthly actuarial rate for enrollees age 65 and over, determined according to paragraph (1) of this section, for that calendar year.".

(2) Section 1839(c) is amended by inserting "(or, if midway between two multiples, the next higher)" before the period.

(3) Section 1839(e) is repealed.

(b) Sections 1844(a)(1)(A)(i) and 1844(a)(1)(B)(i) are each amended by striking out "or 1839(e), as the case may be".

(c) The amendments made by the preceding subsections apply to premiums for years after 1989.

INDIRECT COSTS OF MEDICAL EDUCATION

Sec. 4. (a) Section 1886(d)(5)(B)(ii) is amended --

(1) in subclause (I), by striking out "1995" and inserting instead "1989", and

(2) in subclause (II), by striking out "1995, is equal to $1.43X((1+r)^{.3795} - 1)$ " and inserting instead "1989, is equal to $(1+r)^{.405} - 1$ ".

(b) Section 1886(d)(3)(C)(ii) is amended --

(1) in subclause (I), (A) by striking out "1995" and inserting instead "1989", and (B) by inserting "formerly" after "if the factor", and

(2) in subclause (II), (A) by striking out "1995" and inserting instead "1989", (B) by striking out "and" after "1985" and inserting instead a comma, and (C) by inserting ", and by section 4(a) of the Medicare Budget Amendments of 1988" after "1987".

DIRECT COSTS OF MEDICAL EDUCATION

Sec. 5. (a) Section 1886(h)(2) is amended to read as follows:

"(2) Determination of Hospital-Specific Approved FTE Resident Amounts.--The Secretary shall determine, for each hospital with an approved medical residency training program, an approved FTE resident amount for each cost reporting period beginning after June 1989 as follows:

"(A) Determining Allowable Average Cost Per Resident in a Hospital's Base Period.--The Secretary shall determine for the hospital's first cost reporting period that began after June 1985 the average amount recognized as reasonable under this title for the salary, fringe benefits, and appropriately allocated overhead for each full-time-equivalent resident.

"(B) Amount for the First Cost Reporting Period Beginning After June 1989.--For the first cost reporting period of the hospital beginning after June 1989, the approved FTE resident amount for the hospital is equal to the amount determined under paragraph (A) updated, through the midpoint of the period, by the percentage change in the consumer price index during the 48-month period ending at that midpoint.

"(C) Amount for Subsequent Cost Reporting Periods.-- For each subsequent cost reporting period, the approved FTE resident amount for the hospital is equal to that amount for the previous cost reporting period updated, through the midpoint of the new period, by the percentage change in the consumer price index during the 12-month period ending at that midpoint.

"(D) Treatment of Certain Hospitals.--In the case of a hospital that did not have an approved medical residency training program or was not participating in the program under this title for a cost reporting period beginning after June 1985 but before July 1986, the Secretary shall, for the first such period for which it has such a residency training program and is participating under this title, provide for such approved FTE resident amount as the Secretary determines to be appropriate, based on approved FTE resident amounts for comparable programs."

(b) The matter in section 1886(h)(3)(A) preceding clause (i) is amended by striking out ", for a hospital cost reporting period beginning on or after July 1, 1985," and inserting instead "for a hospital cost reporting period".

(c) Subparagraphs (C) and (D) of section 1886(h)(4) are amended to read as follows:

"(C) Weighting Factor for Certain Residents.--Subject to paragraph (D), such rules shall provide, in calculating the number of full-time-equivalent residents in an approved residency program --

"(i) that the weighting factor ~~for a resident who~~ is in the resident's initial residency period (as defined in paragraph (5)(F)) is 1.00, and

"(ii) that the weighting factor for a resident who is not in the resident's initial residency period (as defined in paragraph (5)(F)) is .50.

"(D) Foreign Medical Graduates Required to Pass FMGEMS Examination.--Such rules shall provide that, in the case of an individual who is a foreign medical graduate (as defined in paragraph (5)(D)), the individual shall not be counted as a resident unless --

"(i) the individual has passed the FMGEMS examination (as defined in paragraph (5)(E)), or

"(ii) the individual has, before July 1986, received certification from, or passed the examination of, the Educational Commission for Foreign Medical Graduates.".

(d) The amendments made by the preceding subsections apply to cost reporting periods beginning after June-1989.

HOSPITAL PAYMENTS UPDATE FACTOR

Sec. 6. (a) Clause (i) of subparagraph (B) of section 1886(b)(3) is amended --

(1) by striking out "and" at the end of subclause (IV),

(2) in subclause (V), by striking out "1990" and inserting instead "1991",

(3) by renumbering subclause (V) as (VI), and

(4) by inserting after subclause (IV) the following:

"(V) for fiscal year 1990, the market basket percentage increase minus 1.5 percentage points for hospitals in all areas, and".

(b) Clause (ii) of that subparagraph is amended --

(1) by striking out "and" at the end of subclause (III),

(2) by renumbering subclause (IV) as (VI), and

(3) by inserting after subclause (III) the following:

"(IV) fiscal year 1989, is the market basket percentage increase, .

"(V) fiscal year 1990, is the market basket percentage increase minus 1.5 percentage points, and".

CAPITAL-RELATED COSTS

Sec. 7. Section 1886(g)(3)(A) is amended --

- (1) by striking out "and" at the end of clause (iii),
- (2) by substituting a comma and "and" for the period at the end of clause (iv), and
- (3) by adding at the end the following:

"(v) 25 percent for payments attributable to portions of cost reporting periods or discharges (as the case may be) occurring during any subsequent fiscal year.".

PERCENTAGE INCREASE IN THE MEDICARE ECONOMIC INDEX

Sec. 8. Section 1842(b)(4)(E) is amended by adding at the end the following:

"(iv) For purposes of this part for physicians' services (other than primary care services) furnished in 1990, the percentage increase in the MEI is 0 percent.

"(v) For purposes of this part for physicians' services (other than primary care services) furnished in 1991 or 1992, the percentage increase in the MEI is 1 percent.".

OVERPRICED MEDICAL PROCEDURES

Sec. 9. (a) Section 1842(b)(10)(A) is amended by adding at the end the following:

"(iv) In determining the reasonable charge for a procedure described in subparagraph (B) and performed during 1990, the prevailing charge for such procedure shall be the prevailing charge recognized for such procedure for 1989 reduced (subject to clause (v)) by 12 percent.

"(v) In no case shall the reduction under clause (iv) for a procedure result in a prevailing charge in a locality for 1990 which is less than 85 percent of the Secretary's estimate of the weighted national average of such prevailing charges for such procedure for all localities in the United States for 1989 (based upon the most available data and determined without regard to physician specialty).".

(b) Section 1842(j)(1)(D)(i) is amended by inserting "for 1988" after "clause (ii)(II)".

RADIOLOGY AND ANESTHESIA SERVICES AND SURGICAL PROCEDURES

Sec. 10. (a) Section 1842(b)(10)(A) (as amended by section 9(a) of this Act) is further amended by adding at the end the following:

"(vi) In determining the reasonable charge for physicians' services that are radiology services, anesthesia services, or surgical procedures (other than procedures described in subparagraph (B)) and performed during 1990, the prevailing charge for such services or procedures shall be the prevailing charge recognized for such services or procedures for 1989, reduced (subject to clause (vii)) by 8 percent.

"(vii) In no case shall the reduction under clause (vi) for a service or procedure result in a prevailing charge in a locality for 1990 which is less than 75 percent of the Secretary's estimate of the weighted national average of such prevailing charges for such service or procedure for all localities in the United States for 1989 (based upon the best available data and determined without regard to physician specialty).".

(b)(1) Section 1834(b)(4)(B) is amended by adding at the end the following: "The fee schedules established for payment purposes under this subsection for services furnished in 1990 shall be 92 percent of the amounts permitted under the fee schedules for services furnished in 1989."

(2) Section 1834(b)(5)(B) is amended --

(A) in clause (i), by inserting "or 1990" after "1989", and

(B) in clauses (ii) and (iii), by striking out "1990" and inserting instead "1991".

(c) Section 1842(j)(1)(D)(ii)(II) is amended by inserting "and services" after "procedures".

NEW PHYSICIANS

Sec. 11. (a) Section 1842(b)(4)(F) is amended --

(1) by inserting "furnished during a calendar year" after "physicians' services", and

(2) by adding at the end the following: "For the first calendar year during which the preceding sentence no longer applies, the Secretary shall set the customary charge at a level no higher than 85 percent of the prevailing charge for the service, for the second year, no higher than 90 percent, and for the third year, no higher than 95 percent."

(b) Section 1834(b)(4) is amended by adding at the end the following:

"(E) New Physicians.--Section 1842(b)(4)(F) shall apply to the fee schedules under this section (treating the fee schedule amounts as prevailing charges and the payments to be made under this subparagraph as the limit on customary charges, and treating the first calendar year during which services are furnished as the period under the first sentence of section 1842(b)(4)(F))."

(c)(1) The amendments made by subsection (a) apply to services furnished after 1989 that are subsequent to services furnished during 1989 or later to which the first sentence of section 1842(b)(4)(F) applies.

(2) The amendment made by subsection (b) applies to services furnished after 1989 that have not been preceded by services to which that amendment would have applied had it been in effect earlier.

CONCURRENT DIRECTION OF NURSE ANESTHETISTS

Sec. 12. (a) Section 1842(b)(13)(A) is amended --

(1) in the matter preceding clause (i), (A) by striking out "and before January 1, 1991," and (B) by inserting "and time" after "base",

(2) in clause (i), by striking out "10" and inserting instead "30",

(3) in clause (ii), by striking out "25" and inserting instead "40", and

(4) in clause (iii), by striking out "40" and inserting instead "50".

(b) Section 1842(b)(13)(B) is amended --

(1) by striking out "and before January 1, 1991,"

(2) by inserting "and time" after "base", and

(3) by striking out "10" and inserting instead "30".

(c) Section 1842(b)(13)(C) is amended by striking out "during the periods in which the provisions of subparagraph (A) or (B) apply".

(d) The amendments made by the previous subsections apply to services furnished after 1989.

LIMITATION ON AMOUNTS FOR CERTAIN SERVICES FURNISHED BY MORE THAN ONE SPECIALTY

Sec. 13. (a) Section 1842(b) is amended by adding at the end the following:

"(14)(A) In determining the reasonable charge for procedures which the Secretary may designate and for which the prevailing charge (but for this paragraph) or fee schedule amount differs if furnished by physicians whose credentials, training, or experience differ, the prevailing charge for a procedure may not exceed the prevailing charge (or fee schedule amount) for that group of physicians who perform the procedure most frequently nationally (as determined by the Secretary).

"(B) In the case of a reduction in the reasonable charge for a physicians' service under subparagraph (A), if a nonparticipating physician furnishes the service to an individual entitled to benefits under this part, after the effective date of the reduction, the physician's actual charge is subject to a limit under subsection (j)(1)(D)."

(b)(1) Section 1842(j)(1)(D)(ii) is amended --

(A) by striking out "and" at the end of subclause (V),

(B) by substituting a comma and "and" for the period at the end of subclause (VI), and

(C) by adding at the end the following:

" VII) a prevailing charge limit established under subsection (b)(14)(A).".

(2) Section 1842(j)(1)(D)(iii)(II) is amended by striking out "or (b)(11)(C)(i)" and inserting instead "(b)(11)(C)(i), or (b)(14)(A)".

(c) The amendments made by the preceding subsections apply to procedures performed after 1989.

END STAGE RENAL DISEASE

Sec. 14. (a) Clause (B) in the first sentence of section 1881(b)(1) of the Social Security Act is amended by striking out "to or".

(b) Section 1881(b)(2)(A) of that Act is amended --

(1) in the first sentence, by inserting "(and for home dialysis supplies and equipment furnished by other entities)" after "renal dialysis facilities",

(2) in the second sentence, by inserting "or other entity that is not a provider of services" after "renal dialysis facility", and

(3) by adding at the end the following: "Payments shall be made to an entity that is neither a provider of services nor a renal dialysis facility only if the entity has agreed to furnish to the individual, for a specified period of time, all home dialysis supplies and equipment, and only if a provider of services or a renal dialysis facility has agreed to furnish to the individual for that period all self-care home dialysis support services and (if necessary) institutional dialysis services and supplies.".

(c) Section 1881(b)(2)(B) of that Act is amended --

(1) in clause (i), by striking out "and renal dialysis facilities" and inserting instead ", renal dialysis facilities, and other entities",

(2) in clause (ii), by striking out "and facilities" and inserting instead ", facilities, and entities", and

(3) by adding at the end the following: "Payments for home dialysis supplies and equipment furnished to an individual during a month by an entity that is not a provider of services or a renal dialysis facility may not exceed the weighted national average of the rates per treatment determined under paragraph (7) multiplied by the national average number of treatments per month per individual for which payment is made under this section.".

(d) (1) Section 1881(b) (6) of that Act is repealed.

(2) Section 1881(b) (4) of that Act is amended by striking out "on the basis of a target reimbursement rate (as defined in paragraph (6)) or".

(3) Section 1881(b) (7) of that Act is amended by striking out the fifth sentence.

(e) The amendments made by the preceding subsections apply to items and services furnished after the third month that begins after the date of enactment of this Act.

DURABLE MEDICAL EQUIPMENT

Sec. 15. (a) Paragraph (7) of subsection (a) of section 1834 is amended to read as follows:

"(7) Payment for Other Items of Durable Medical Equipment.--In the case of an item of durable medical equipment not described in paragraphs (2) through (6) --

"(A) payment shall be made (I) in a lump-sum amount equal to the purchase price recognized under paragraph (8), or (II) on a monthly basis for the rental or lease-purchase of such item during the period of medical need (but payments under this paragraph may not extend over a period of continuous use of longer than 15 months for lease-purchase, after which title shall pass to the individual, or 12 months for rental), and the amount recognized for each such month is 10

percent of the purchase price recognized under paragraph (8) with respect to the item;

"(B) during the succeeding 6-month period of medical need (in the case of rental or lease-purchase), no payment shall be made for maintenance and servicing; and

"(C) during the first month of each succeeding 6-month period of medical need (beginning with the date of purchase, in the case of a lump-sum purchase), a maintenance and servicing payment may be made (for parts and labor not covered by the supplier's or manufacturer's warranty, as determined by the Secretary to be appropriate for the particular type of durable medical equipment) and the amount recognized for each such 6-month period is the lower of (i) a reasonable and necessary maintenance and servicing fee established by the Secretary, and (ii) 10 percent of the total of the purchase price recognized under paragraph (8) with respect to the item.

The Secretary shall determine the meaning of the term 'continuous' in the preceding sentence."

(b) Paragraph (8)(A)(i) of that subsection is amended to read as follows:

"(i) The carrier shall compute a base local purchase price for each item equal to the average reasonable charge in the locality for the purchase of the item for the 12-month period ending with June 1987."

(c) Paragraph (8)(C)(i) of that section is amended by striking out "(A)(ii)(I)" and inserting instead "(A)(ii)".

(d) The amendments made by the preceding subsections apply to covered items furnished after 1989 (and the reference in subclause (II) of clause (ii) of section 1834(a)(8)(A) of the Social Security Act to the local purchase price computed under

that clause for 1989 is to that price as it would have been computed for that year under the amendment enacted by subsection (b) of this section).

OXYGEN AND OXYGEN EQUIPMENT

Sec. 16. (a) Subparagraph (A)(ii) of paragraph (9) of section 1834(a) is amended --

(1) by striking out "or" at the end of subclause (I),
 (2) in subclause (II), by striking out "1990, 1991" and inserting instead "1991",

(3) by renumbering subclause (II) as (III), and

(4) by inserting after subclause (I) the following:

"(II) to 1990, equal to 95 percent of the local average monthly payment rate computed under subclause (I) increased by the percentage increase in the consumer price index for all urban consumers (U.S. city average) for the 12-month period ending with June 1988, or".

(b) Subparagraph (B)(i) of that paragraph is amended by striking out "(A)(ii)(II)" and inserting instead "(A)(ii)(III)".

(c) Clauses (ii) and (iii) of subparagraph (C) of that paragraph are each amended by striking out "(A)(ii)(II)" and inserting instead "(A)(ii)(III)".

ENTERAL NUTRITION NUTRIENTS AND SUPPLIES, AND PARENTERAL AND ENTERAL NUTRITION EQUIPMENT

Sec. 17. (a) Paragraph (1) of subsection (a) of section 1834 is amended by inserting "and (14)" after "(7)" each place it occurs.

(b) Paragraph (2)(B) of that subsection is amended --

(1) by substituting a comma for the period at the end of clause (ii), and

(2) by adding "except that the amount for an item of parenteral or enteral nutrition equipment shall be determined as provided by subparagraph (A) or (B) of paragraph (14)." after clause (ii).

(c) Paragraph (6) of that subsection is amended by striking out "or (5)" and inserting instead "(5), or (14)".

(d) The matter in paragraph (8) of that subsection preceding subparagraph (A) is amended by inserting "(except that the amount for an item of parenteral or enteral nutrition equipment shall be determined as provided by subparagraph (A) or (B) of paragraph (14))" before the colon.

(e) Paragraph (13)(B) of that subsection is amended by striking out "and enteral nutrition nutrients, supplies, and equipment" and inserting instead "nutrition nutrients and supplies".

(f) That subsection is amended by adding at the end the following:

"(14) Payment for enteral nutrition nutrients and supplies.--Payment for enteral nutrition nutrients and supplies shall be made in a lump-sum amount for the purchase of the item equal to --

"(A)(i) for an item furnished in 1990 (or in a later year in which an item is first available), the amount specified in a fee schedule developed by the Secretary (based on appropriate price information as determined by the Secretary), or

"(ii) if lower for an item furnished in 1990, the lowest charge level for the item (as determined under section 1842(b)(3)), or

"(B) for an item furnished after 1990 (other than in a year in which an item is first available), the amount determined under this paragraph for the previous year increased by the percentage increase in the consumer price index for all urban consumers (U.S. city average) for the 12-month period ending with June of the previous year.".

(g) Section 1861(n) is amended --

- (1) by striking out "and" after "hospital beds," and
- (2) by inserting ", and parenteral and enteral nutrition equipment" after "may prescribe)".

CLINICAL DIAGNOSTIC LABORATORY TESTS

Sec. 18. (a) Subparagraphs (B) and (C) of section 1833(h)(1) are each amended --

- (1) in the first sentence, by striking out ", and ending on December 31, 1989", and
- (2) by striking out the second sentence.

(b) Section 1833(h)(4)(B)(ii) is amended by striking out "and so long as a fee schedule for the test has not been established on a nationwide basis,".

MEDICARE CUTS

Senator JOHNSTON. I had not gotten the Medicare things. I think you are going to find Medicare is a lot harder to cut than we thought. We tried to do that last time. It is hard to ring money out of there.

Mr. DARMAN. It may be, sir, but it is not quite as hard as has been advertised because as I have tried to suggest, \$2 billion is really, I think, in fact well-known to some of the drafters. That \$2 billion is in there so that someone can work very hard and save it.

LINE ITEM VETO

Senator JOHNSTON. I end by just making one little comment here—I think my time is close to up—but I notice that the President is for the line item veto, and many of us have urged that in lieu of the line item veto he try, at least, the rescission process, where he can go in and rescind anything that he does not like to the same extent that he could using line item veto.

And so I was amazed to find in appendix H, note 1, that President Reagan's rescission proposal are withdrawn except for those that offset proposed spending increases so that even the small amount of rescissions that President Reagan had are now withdrawn so we are not using the rescission power at all.

How can you argue for the line item veto when you are not even using the rescission process?

Mr. DARMAN. Well, we strongly favor an enhanced rescission authority, but the existing rescission authority—over the decade of the 1980's we have succeeded with, I would think, something substantially less than 5 percent of the requests for rescission.

Senator JOHNSTON. Yes, but you can make a point. I mean you go out and say where you stand on these cuts.

Mr. DARMAN. That just has not produced any savings. It is a little bit artificial, and if we could get an enhanced rescission authority which we would very much like to have, then the success rate when we propose rescissions would rise maybe even to double digits, and we could start to save a little money. So we agree with you in policy terms, I mean in terms of the process change. We would like to have that change. Thank you, Senator.

The CHAIRMAN. Thank you, Mr. Johnston. On that enhanced rescission authority, that is a super line item veto. That is worse than a line item veto, with all due respects to Senator Johnston and Mr. Darman. Mr. McClure.

IMPROVED EXECUTIVE-CONGRESSIONAL RELATIONS

Senator McCLURE. Thank you very much, Mr. Chairman. I will be very brief. It is impossible for us in an oversight in 10 minutes to anymore than just dip the surface at two or three points. I do want to underscore something, however, that perhaps needs emphasis, and that is I want to commend President Bush and you for having offered to the Congress the opportunity to negotiate the shape of the budget.

Mr. DARMAN. Thank you, sir.

Senator McCLURE. It seems to me to be obvious that this is something new. Senator Hatfield made a reference to that, and I do not want to be critical of the past administration, but urge that Congress accept the offer that has been made. It seems to me too apparent to ignore that there are those that do not want to accept the opportunity to negotiate because it also encompasses the responsibility to make decisions.

It is far too easy too often to sit back and say, no, Mr. President, you first. So that we can beat you about the head and shoulders for a few months before we come to the same conclusions. But we would like the political advantage of being critical of your proposed cuts. There are enough arguments between the Congress and the administration to provide all the political grist for the mills for the entire year. And I recognize that process is here.

But I do want to commend you both for the offer to negotiate and urge that Congress resist the temptation to play politics with that offer and with that negotiating process, although I know that is not going to happen.

CURRENT SERVICES BUDGETING

Second, I wish to commend you for highlighting the difficulty we have had with current services budgeting. There is one great contribution of the last decade. I do not hear very many people any longer saying deficits do not matter. I think maybe President Reagan got us over that or perhaps it was the economic conditions of the late 1970's and early 1980's that got us over that. But it is a bipartisan effort, both sides of the aisle participating, saying we have got to do something about budgets.

I am grateful we have made that progress in the political dialogue of this country. Now maybe we can make the next step in that progress equally, and that is talk about real growth in spend-

ing. And in order to do that we have to look at current services budgeting.

Now current services budgeting may help us in terms of where we wish to set priorities, but Congress has the responsibility for setting priorities. The President of the United States, if I read the constitution at all correctly, the President of the United States has no power of the purse. Congress very clearly and carefully constrained his power. President Nixon tried to use rescissions and impoundments, and the Congress says, oh, no, you do not; we are going to force you to spend every dime you have we have appropriated.

Now I think that may be appropriate for Congress to do, but it is not appropriate for Congress to do that and then blame the president for the deficit. I have heard a lot of rhetoric over the last few years about the Reagan deficit, the Reagan debt. Baloney. Congress appropriated every dime of it.

Congress is responsible for every penny of the national debt. A president did not spend one penny that was not first appropriated by the Congress of the United States and later insisted that the expenditures be made. I hope that at the same time that, we say that the administration will also accept the responsibility for keeping their part of the bargain struck.

Occasionally we see the administration trying to get the benefit of having an agreement and then escape the consequence of the agreement by saying, oh, but I do not like that part of it. There are a couple of areas which I will not go into very deeply, but one of them is the Bonneville Power repayment. A bargain was struck. I think the argument that, indeed, the Government should not have made the agreement is a valid argument perhaps if you want to go back and try to rewrite history. It is a little like the bank coming to you after you have signed a mortgage, and said, oh, but the interest rates have risen, and I do not think I ought to be stuck with your repayment schedule on your mortgage because the bank could make more money today if we were not stuck with that.

As a matter of fact, savings and loan associations would not have gotten in all the trouble they are in had they been able to rewrite all of their mortgages to the modern interest rates that post-date the entering into of the agreement.

Another one that Senator Hatfield mentioned, or Senator Stevens perhaps, Congress is fairly dumb but not too dumb. We do see some things that happen down at OMB as a matter of fact, and that is the question that comes with the rather curious policy when you develop new budgets of zeroing out whatever it was that Congress added last year. I think those of us who have been around here a year or two know that is a policy and it is a practice.

I would hope that OMB would recognize that those appropriations last year that the administration had not thought of that were the action of the Congress were imbedded in bills that were compromised between the legislative branch and the executive branch and were signed by the President of the United States. The President and the administrative agencies ought to take some responsibility for those agreements that were struck whether it was last year's bill or last decade's agreement or repayment schedules for Bonneville entered into 30 years ago.

LONG-TERM PLANNING—INVESTING IN THE FUTURE

One of the rather important areas that Senator Hatfield touched on and I want to reemphasize is an area upon which you have spoken in the last several months, and again I wish to commend you for what you have said, in terms of being more concerned about long-term consequences than short-term advantages. That certainly fits with respect to natural resources management, and investment in reforestation of national forest land has no repayment this year, next year or 2 years from now. It has repayment 30 years, 40 years, 50, 60 years, in the case of the Tongass 100 years from now.

Yet those are investments in the future that impact the budget today, and Mr. Darman, I would just like your reaction a little bit to that question of long-term consequences and our ability to make the investments on a predictable basis that are necessary in long-term natural resource management, not just in timber. We are talking about fish and wildlife. We are talking about habitat. We are talking about anadromous fish. There are a whole host of things that really do not have an immediate payback, but are so very important in terms of future consequence.

Mr. DARMAN. Thank you, Senator McClure. Thank you for your several comments before this question. On this question, you are quite right that I have been trying for some years in speeches I have made to argue that we need to pay more attention as a society to long-term investment. That applies to the private side as well as to the public.

I once got myself in a little degree of trouble by arguing that private managers ought to spend more time worrying about their own long-term investment in research and development and long-term strategy development and things of that kind. It is not peculiar to the public side. It is a problem for the society as a whole in my opinion.

On the public side from OMB's perspective, what I am interested in doing is seeing us—not abandon the existing budgeting process, I do not want to be misunderstood on this—but I would like to see us add to it more analytic attention to the presentation and discussion of issues of longer term investment that would apply not only to natural resources but to all kinds of capital assets. It would also apply to the treatment of some trust funds, and it would apply to human capital development as well.

So I would hope that while we have not been able to do it by February 9, that our first full budget presentation would be able to get at some of these long-term investment issues a little more systematically, and just as we have been able to focus public attention on the deficit, I would like to find a way to focus public attention at a later stage on some of these larger issues that affect future generations.

The hard part is doing it right analytically because as you know, there is a tremendous amount to argue about as to what are the returns on these investments and what are appropriate depreciation schedules and all these kinds of technical issues.

It also has to be done in a way that does not create a new incentive to over-invest. We do not need to over-correct under this head-

ing. So we have not fully worked that out, but you are right that it is important that we judge it to be important, and we will try to be an awful lot better in analysis on this over the year, and years to come, if we get by the next few weeks.

Senator McCURE. Mr. Darman, I commend you on that statement. Of course, we look at the long-term value of investments in education, in health care, in aid to the handicapped, the human capital which you referred to which is at least as important as the attention we should pay to long-term management of natural resources. But so often in short-term crises in the budget, we cheat long-term programs in order to meet current crises and then we build an even worse future crisis.

The CHAIRMAN. Senator Burdick.

CONSERVATION RESERVE FUNDING

Senator BURDICK. Thank you, Mr. Chairman. The Food Security Act of 1985 requires a minimum of 40 million acres to be entered into the Conservation Reserve Program through the 1990 crop year. The budget request contains sufficient budget authority to enter 40 million acres. However, the outlays estimated were reduced by OMB to accommodate 35 million acres. USDA estimates that in the outlays \$2.039 billion would be needed to support 40 million acres. OMB has only requested \$1.771 billion.

My question is why?

Mr. DARMAN. Sorry, Senator. I was listening. But I am just also simultaneously trying to find out whether I understand it correctly.

Senator BURDICK. Should I read it again?

Mr. DARMAN. No, I heard it completely. Thank you very much. Senator, I do not have a satisfactory answer to that. I do not know why our estimate differs from what it ought to, and I will have to find out.

Senator BURDICK. No difference in estimates. The difference is in how you apply it. There is authority for 40 million acres.

Mr. DARMAN. But I understand we are at 35 million acres in our assumption, and I do not know what accounts for that.

Senator BURDICK. Will you answer that at an early date?

Mr. DARMAN. I will be happy to try to get back to you today. I just apologize for not having it at the moment.

The CHAIRMAN. Would you submit something for the record also, Mr. Darman?

Mr. DARMAN. Yes, sir.

The CHAIRMAN. Mr. Leahy.

CONCERN ABOUT THE RESIDUAL FREEZE

Senator LEAHY. Thank you, Mr. Chairman. Mr. Chairman, personally I want to commend you for having this type of hearing right at the beginning of the year. I think it is extremely helpful to all of us. I am reminded of two comments—yours that the administration gets a gain; we get the pain. I am also reminded of Senator Sasser's statement that I mentioned to Mr. Darman earlier this morning that the President asked for a line item veto, and we would just kind of like to have a line item budget.

I have a couple of problems with your budget plan. It calls for \$9.6 billion in cuts in domestic spending programs, but it does not say which programs should be cut. The economic forecasts have been bent out of shape to, I think, underestimate the deficit. You know when they start talking about this budget and they talk about projections of 6 percent or 7 percent interest rates, I do not know many Vermonters who feel they are going to be able to borrow money next year at 6 or 7 percent interest rates.

In fact, when you first came out with the prediction, I think the next day the prime was at 11 percent. Every time the prime rate increases by just one point, there are thousands of people in my State of Vermont who are priced out of the housing market, probably throughout the country.

Now your freeze, the administration's freeze, is probably well named. It will literally put 150,000 Americans, again many in Vermont, out in the cold. These are the people who have assistance through the LIHEAP program. So here are my specific questions. Does the administration support cutting Low Income Home Energy Assistance, LIHEAP, yes or no?

Mr. DARMAN. Yes.

Senator LEAHY. You do support cutting it by how much?

Mr. DARMAN. It is basically the Reagan proposal that we have on the table consistent with the discussion with Senator Byrd.

Senator LEAHY. If you could give me that figure by how much it is going to be cut, please? If you have it right there, go ahead.

Mr. DARMAN. Senator, in 1989 it is at \$1.38 billion in budget authority, and under our option one which is the one on the table for purposes that you are interested in, it is \$1.1 billion for 1990. And in outlays for 1989 it is \$1.37 billion, and under our proposal under option one it would be \$1.125 billion.

BUDGET SMOKE AND MIRRORS

Senator LEAHY. Now President Bush's budget submission calls for a \$2 billion cut in farm programs. President Reagan asked for a \$2 billion cut also, but he got \$900 million by shifting funds from fiscal year 1990 into fiscal year 1989. If you compare the numbers on pages 185 and 189 of "Building a Better America," it suggests that President Bush is also calling for this shift from fiscal year 1990 to fiscal year 1989.

Does not that sort of get into budget smoke and mirrors? I mean how long can we keep this juggling going before sooner or later somebody actually has to pay the bills?

Mr. DARMAN. I do not think that that particular one is budget smoke and mirrors, Senator. First of all, I think you will find that in one of my appendices the number is specifically identified as associated with accelerating the deficiency payment. I agree with you that it is a one-time saving for fiscal year 1990, and that we cannot make a long-term budget just out of such savings.

DROUGHT ASSISTANCE FUNDING

But on the other hand, this particular proposal is intended to address a serious problem associated with the drought. At least that is my understanding of it. There is a need in the near term because

of the drought for an acceleration of the deficiency payments. It was my understanding that that was the sentiment of a large number of congressional representatives of agricultural interests.

Senator LEAHY. Actually we saved a great deal of money and paid for the drought last year out of savings. But as I read these cuts, and as those of us in Senate Agriculture Committee that looked at them read it, you have either a 10-percent cut or 20-percent cut, depending upon which way you use it. Maybe the fact that it is hard to tell whether it is a 10- or 20-percent cut shows that it is fairly artfully written if you are trying to hide a cut, inartfully written or not.

My concern is not as to help for the drought or a possible drought this year, but we now have a situation where the Secretary of Agriculture and the new trade negotiator are dealing with the European Community about how we will negotiate trade and agricultural subsidies.

To boil it down to simplest terms they, the Europeans say, in effect, why not let you guys cut everything over here in the United States through the budget process. We will watch it for a few years, and if it seems like a good idea, we might do the same. Or in other words, suggesting unilateral disarmament to us. Many of us feel that we ought to do these cuts in lockstep with them so that we do have a way to be able to keep our export market and not lose more of it in one of the few areas where we actually have a trade surplus.

But if you look at this, if you are one of the Europeans why would you not just hold back and let the Bush administration just cut our commodity programs in such a way through the budget process that we cannot compete in exports, the Europeans take over that market, our trade deficit goes up, surplus that we used to enjoy in agriculture disappears, and we have unilaterally disarmed ourselves in this aspect of trade. Or am I missing a point in there somewhere?

Mr. DARMAN. No, I am sure that you are not missing a point, Senator. All I can say is that I looked at the Reagan proposals, which we modified only very slightly here, to give the Secretary of Agriculture more freedom in the process, but the substance is basically the same. Not knowing much about agriculture programs myself—though I have been in six Cabinet departments, that does not include agriculture—and I have to confess—

Senator LEAHY. Count your blessings. Count your blessings.

Mr. DARMAN. Well, I would be happy to serve there but I have not yet. I went to Clayton Yeutter, who is, I think, acknowledged and well respected as an expert both in the field of agriculture and in international negotiation on the subject, and asked him exactly this question. And he said—I do not mean to unfairly put words in his mouth since he is not here—but he did suggest that he thought that there were ways constructively to reorient the farm program if he were given enough latitude to work it out with the Congress in a way that would not adversely affect what is going on in international negotiations.

So I defer to his judgment on that. It is, as you have suggested, only \$1.1 billion, not the full \$2 billion, that should be viewed as the cut. The remainder is budget accounting. It is not misleading

budget accounting, but it is budget accounting in the sense that it does not continue.

Senator LEAHY. Well, it is probably not misleading in the sense that we know there is going to be a huge budget cut in agriculture, but I would join with you in the praise of Secretary Yeutter. While he and I obviously have some areas that we may disagree on, I have a great deal of respect for his competence. I applaud President Bush in appointing him.

As you know, my committee voted unanimously in very short order to support his nomination as did the full Senate. But it is one thing to say, and this is the problem that I have and I think the problem that a lot of other Senators have, we have these figures in there for savings. We will save \$2 billion, and then in the small print it says, and people will work that out.

PROPOSED NEW FARM BILL

Well, working it out is the concern. We are about to write a new farm bill. We are going to start writing one this year. This could change dramatically the whole complexion of it. It also sends a signal, I believe, when you simply say there are going to be cuts without saying what it is going to do to our trade picture, it sends a very solid signal to the European Community which has sat there eating our lunch both literally and figuratively for years, to just sit on their hands some more as they normally do waiting for us to unilaterally disarm, and then they take over that part of the trade picture.

The point I make, Mr. Darman, is it is nice to say we are going to balance the budget, but it is even more important to say to the American people when we do this, when we save this money, here is what the ultimate effects are, and if it loses thousands of jobs involved with the export business or our whole agricultural sector, then we ought to say so.

Mr. DARMAN. Senator, would you like me to comment?

Senator LEAHY. Yes.

Mr. DARMAN. Let me just attempt to explain my own thinking on this. First of all, on the \$2 billion, there is no intention to misrepresent; \$850 million, almost \$900 million of that is in the accelerated deficiency payment. It is good on its own merits. My understanding is it is welcome in the agricultural community. It has the disadvantage of not being a continuing saving.

So it is the remainder that is farm program readjustment. Now the issue, as I saw it, was should we try to accelerate that because it is scheduled for review in 1990. I thought that the practical alternative would likely turn out to be, since that is an election year, 1991 or no cuts in 1990, or an opportunity to accelerate farm program reform in a constructive way hopefully in 1989. So this is oriented toward accelerating that.

Now I am not expert in this field, and there was one proposal which would do this by changing target prices. Another proposal within OMB, with which I am sure you are perhaps more familiar than I, has to do with cutting back on the base and allowing farmers to take the difference, and produce whatever they wanted in that respect.

I did not feel I had enough expertise and experience to determine that the OMB position was the right position and to try to argue that with the President. So I suggested that we say that is one option. We have another option, both of which are identified in the book on page 122, but we entrust the Secretary of Agriculture with the job of trying to find the right formulation working with the Congress. It seemed to me a sensible approach. That is the explanation.

Senator LEAHY. Mr. Chairman, my time is up. I would ask unanimous consent that I be able to submit further questions on both this issue and on the foreign aid budget which comes under my subcommittee on this committee.

The CHAIRMAN. There being no objection, it is so ordered.

Mr. Domenici.

Senator DOMENICI. Thank you very much, Mr. Chairman. Mr. Darman, as I have mentioned to Chairman Byrd, I have not been able to be present because Alan Greenspan has been before the Budget Committee for about 3 hours. I apologize to you for not hearing your testimony. I hope I am not going to be repetitious in my questions.

RESIDUAL FREEZE CATEGORY ASSUMPTIONS

Mr. Darman, a lot has been said about the \$120 billion in discretionary appropriations that is in the freeze category. I am correct, am I not, that as far as discretionary appropriations and the categorical freeze go, that is about the right number, about \$120 billion?

Mr. DARMAN. That is correct, Senator.

Senator DOMENICI. That results from removing from the categorical freeze proposal some mandatory spending and some defense spending?

Mr. DARMAN. Yes; 10 and 6 respectively.

Senator DOMENICI. So that when we were talking about \$136 billion heretofore, \$120 billion was within this committee's direct appropriations jurisdiction; is that what we are saying?

Mr. DARMAN. Well, actually the six non and the six that is in defense.

Senator DOMENICI. The six and the six, but in another category.

Mr. DARMAN. Right.

Senator DOMENICI. I should have said the discretionary domestic spending category.

Mr. DARMAN. Right.

BACKGROUND ON BUSH BUDGET

Senator DOMENICI. Mr. Darman, I have looked at the documents that President Bush presented to us, and I want to state for the record that the material is extensive. I have attempted to review what other Presidents have submitted in the first couple of months of their administrations and upon which the Congress acted. I find that, quite to the contrary of what I am hearing, the Bush administration has submitted more detail than any previous administration.

Having said that, the President also proposes a number of domestic discretionary program initiatives that would require increased funding; is that correct?

Mr. DARMAN. That is correct, Senator.

Senator DOMENICI. You propose some specific programs that would be reduced; is that correct?

Mr. DARMAN. Right.

Senator DOMENICI. What I think is important to this committee—since specific funding levels for individual programs ultimately resides with the appropriators—is that instead of talking only about the \$120 billion, could you tell us how many billions of dollars are in the discretionary domestic category in total, including those that are increased, those that are reduced, and those that are frozen? And if you have the number, how much of that sum total will increase in outlays year over year both in dollars and in percentage?

Mr. DARMAN. Yes, Senator. The total nondefense discretionary group as presented by President Bush would be \$182.4 billion. I just quickly did the percentage increase. It is 2.85 percent, about 2.9 percent, could round to 3 percent.

Senator DOMENICI. So if I have been using 3 percent as the increase in the discretionary domestic accounts, I am close to right? It is 2.9 percent, you say?

Mr. DARMAN. It is 2.9 percent, but 3 percent is close enough for Government work, as they say.

Senator DOMENICI. I know that this committee also has jurisdiction over defense spending, although we are not talking much about it. Rather than waste a lot of time with my question, I have done the same calculation for defense spending. Am I correct that defense spending is going up in outlays, year over year at about seven-tenths of 1 percent; is that correct?

Mr. DARMAN. If you included the cleanup activities? If you just took the Department of Defense, I think it would be smaller, about four-tenths of 1 percent.

Senator DOMENICI. All right. So that for those who would like to compare the increase year over year of defense with discretionary domestic appropriations, we have established that it is about 3 percent for domestic discretionary programs, and somewhere between four-tenths of 1 percent and seven-tenths of 1 percent for defense spending.

Mr. DARMAN. Correct.

Senator DOMENICI. To be more specific, do I understand that you are saying to us that there are President Bush's priorities for funding increases, there are some programs that he clearly wants to reduce, and for the rest, we will negotiate. If we do not want to negotiate, we could freeze them all at last year's outlay level and pay for them all; is that correct?

Mr. DARMAN. That is correct, or alternatively you could for the \$120 billion take the Reagan proposals and come out with the same number that way.

Senator DOMENICI. Right. The Reagan budget had a number of program terminations, which permitted some increases?

Mr. DARMAN. That is correct.

Senator DOMENICI. All right. So that for those who say that Ronald Reagan's budget increased funding for one of these programs, to tell the whole story, we would have to say that on the other hand, he eliminated 82 programs, that is how he paid for them; is that correct?

Mr. DARMAN. That is correct.

GRAMM-RUDMAN-HOLLINGS SEQUESTER ESTIMATES

Senator DOMENICI. Turning to the possibility of a sequester, I am concerned about some numbers I have heard. You have recently made public calculations showing the comparison of the estimated Gramm-Rudman-Hollings sequester levels with the Bush budget request.

In this table you have assumed sequester percentages, and if I am wrong on any of these, Mr. Darman, please correct me, of 8.5 percent for defense and 8.4 percent for nondefense. Am I correct thus far?

Mr. DARMAN. It is 8.4 percent for nondefense. You are probably correct. Let me just double check the other one, though. You are right; 8.5 percent for defense.

Senator DOMENICI. Now Mr. Darman, as I understand the calculations which you made available for the postsequester level for nondefense discretionary spending, both domestic and international affairs spending would exceed, according to the numbers I have, the fiscal year 1989 funding levels in both cases.

Mr. DARMAN. Right.

Senator DOMENICI. For nondefense discretionary spending, the postsequester level would be \$1.2 billion higher than fiscal year 1989, or \$178.3 billion after a sequester, compared to \$177.1 billion in fiscal year 1989?

Mr. DARMAN. Right.

Senator DOMENICI. I could do the same comparison for foreign affairs, and the postsequester level would be \$100 million higher than in fiscal year 1989, or \$16.4 billion versus \$16.3 billion. Now Mr. Darman, I understand we have got some wild baselines, and the Gramm-Rudman baseline is different than others.

But how could you have an 8.4 percent and 8.5 percent reduction in spending under a Gramm-Rudman sequester, and end up with a level of funding that would exceed the spending levels in the current fiscal year? I do not understand that. It seems to me that it would not be a direct 8 percent or even a direct 4 percent. But it seems to me that it ought to be less than, and not more than, the fiscal year 1989 levels of spending.

Mr. DARMAN. It is basically the way the Gramm-Rudman rules work that for a lot of these programs you first have to build in the growth, and then you cut back from the baseline growth.

Senator DOMENICI. They are complicated rules, and the Gramm-Rudman baseline is different than any others in that it basically builds in a lot of increases, and then when you reduce programs under a sequester, you do not really cut them but the new increase.

The sequester calculations do seem misleading, and I am merely asking that you check those calculations again, to see if you are correct. I very much would like to see that in detail and there are

tables A-18 and A-19 in the budget analyses document on pages A-46 and A-47 that I request that you update and submit for the record.

Mr. DARMAN. I do not know if those are the correct numbers, but I would be happy to.

Senator DOMENICI. I think they are. Mr. Chairman, I would like to ask that those tables be made a part of the record. I think they are relevant. And, Mr. Darman, with all the other things you have, would you mind seeing if those sequester calculations are correct, and for the record, provide us with whatever anomalies you find, if any?

Mr. DARMAN. Yes, I would be happy to do, sir.

Senator DOMENICI. Thank you, Mr. Chairman.

The CHAIRMAN. Without objection it is so ordered.

Senator BUMPERS.

Senator BUMPERS. Mr. Darman, let me say first of all I have never known you before, but you are certainly, at least your demeanor is a breath of fresh air compared to what we have put up with for the past 8 years.

Mr. DARMAN. Thank you, sir.

STATUS OF SBA REPROGRAMMING REQUEST

Senator BUMPERS. David Stockman sat where you sat in 1981, and many of us accused him of putting the whole budget together on the back of an envelope. He vehemently denied that and then made \$1 million on a book admitting it. While I would be less than fair if I did not also say that I think this budget is totally unrealistic, at least you do about as credible a job of defending it as I think is possible under the circumstances. Let me ask you this question. The SBA has asked you to permit them to reprogram \$200 million for their guaranteed loan fund. What is the status of that request?

Mr. DARMAN. It is under review, and I do not have the answer as to what we are going to do, but I think we are likely to do what you would wish. You know this arose because of our apportioning one portion of that budget on a quarterly basis, just dividing the total by four. And then they bump up against the ceiling, and the question is can you reprogram from other authorities, and what transfer? I am favorably disposed to the idea, but I have not formally made the decision yet.

Senator BUMPERS. Mr. Darman, I am pleased to hear that, and I wish you would hurry up and expedite that because the demand under this program is up precipitously this year, up 17 percent in California. California and Texas, as you know, are the two big users of this program compared to other States. We are going to run out of money this year, but we do need that reprogramming because the demand is up dramatically.

IMPACT OF CHANGING ECONOMIC ASSUMPTIONS

Mr. Darman, you say in the budget that you assume that the interest rate in 1990 in your budget will be 5.5 percent. What if you miss that a point? What if it is 6.5 percent? How much does that raise the deficit?

Mr. DARMAN. Generally speaking, if you did it by itself, it would probably raise the deficit about \$5 billion. But Senator——

Senator BUMPERS. I understand the interplay. I just want to ask——

Mr. DARMAN. One important interplay. That is the one with inflation because it is virtually inconceivable that the interest rate, one, will be off by a full percentage point without the inflation one also being off in the same direction, and that gives you back some of the money.

Senator BUMPERS. Well, let me ask you a more current question. The assumption on this year's budget is that the interest rate will be 6.3 percent. As of this moment, it is 8.5 percent, 2.2 percent off. What does that do to this year's deficit?

Mr. DARMAN. Nothing in and of itself. Our estimate is for the current quarter right at reality at 8.3 percent, and the question is whether our slope is right, whether that sharp downward slope is right. If we do not get a budget agreement fairly soon, and the Fed follows its current policy, I would say that that slope clearly will not be right.

We should all want to get that slope coming down sharply, and the chairman of the Fed himself has said, and I assume repeated again this morning, that if we get a budget agreement even close to the type we are talking about, he would expect to see rates come down sharply. So I do not think the slope is unreasonable. The question is how soon do we get to where you can start down that path, and that is a function of how quickly we will be able to work things out.

Senator BUMPERS. Mr. Darman, in all fairness we listened to that same argument 1 year ago in this very room, and now interest rates are 2.2 percent higher than they were under the budget assumptions last year.

Mr. DARMAN. I did not participate in it, you know, sir.

Senator BUMPERS. I know you did not, but I must say I think you are the only person in this room, indeed on this Hill, who believes interest rates are going to be 5.5 percent next year.

Mr. DARMAN. I never said that I believed that, Senator.

Senator BUMPERS. Well, why did you put that in the budget?

Mr. DARMAN. I have said specifically in my testimony, in the prepared testimony that I delivered to the Congress, that I think these projections are optimistic on the interest rate assumptions, and I further said that I thought that they were highly conditional, dependent upon our reaching agreement in a timely manner which is inherently an uncertain matter.

INFLATION RATE

Senator BUMPERS. I do not understand when you say it only amounts to \$5 billion. Let me finish my question, and I will come back to that. In the 1990 budget, what do you assume the inflation rate will be? Is it 4.2 percent?

Mr. DARMAN. In?

Senator BUMPERS. 1990.

Mr. DARMAN. In calendar 1990 it is 3.7 percent. In—just one second—well, the GNP deflator for the fiscal year is 4 percent, so that must be roughly right.

Senator BUMPERS. Four points?

Mr. DARMAN. Right.

Senator BUMPERS. What if you miss that, what is the effect on the budget if you miss that by a point?

Mr. DARMAN. Inflation?

Senator BUMPERS. Yes.

Mr. DARMAN. Inflation will not necessarily make the deficit worse because it depends what has happened to real growth. If you just add inflation to GNP and you add the same real growth, you will have higher nominal growth, so you will have higher revenues, and that tends to offset the higher spending.

Senator BUMPERS. But you cannot have all of these things, can you, Mr. Darman?

Mr. DARMAN. Do not want them.

Senator BUMPERS. You cannot have a 5.5 percent interest rate, which would indicate a lack of economic activity and still enjoy a 3.5 percent GNP rate. And as I understand it, for every rate you miss on GNP, you are talking about over \$20 billion added to the deficit; is that not a fair statement?

Mr. DARMAN. I think that that could be right, all other things being equal.

Senator BUMPERS. Well, what is your assumption on GNP rate for 1990? Is it 3.5 percent?

Mr. DARMAN. That is right.

Senator BUMPERS. Alan Greenspan says that would be outrageous if it hits that. How do you feel about that?

Mr. DARMAN. I did not hear him use the word outrageous.

Senator BUMPERS. Well, he might not have used the term outrageous, but he says if the growth rate continues at that pace, he has no choice but to continue raising interest rates, which takes us back to my first question.

Mr. DARMAN. Well, Senator, I do not mean to be at odds.

Senator BUMPERS. Well, I am argumentative so you go ahead and be argumentative, too, if you want to be.

Mr. DARMAN. I am not at all one of these people who believes—and I spared you reading or even including in this testimony the long dissertation that I gave to the Budget committees—

Senator BUMPERS. We are grateful.

Mr. DARMAN [continuing]. On interest rates and these other elements of economic assumptions—but I am one of those people most critical of the macroeconomics profession—not microeconomics, but macroeconomics. I spent a good deal of my life dealing with microeconomics, and I have very little respect for the validity, reliability of macroeconomics.

There is an enormous record to demonstrate how wrong we can be. The direction in which we could be wrong is both ways. That is what makes the problem in some ways even more annoying. If you look back over the decade of the 1980's, and you were referring to David Stockman, one of the things that that initial forecast was criticized for being too rosy about was interest rates. What happened to interest rates? Interest rates came in much, much lower

than had been forecast over the period of the early Reagan-Stockman era.

Now I am not saying we should repeat that because it was thanks to excessively tight monetary policy. But, I think it is a little more complicated than just asserting that it must be the case that if real growth is high, interest rates must be high. In some conditions, that may be right.

I think the better way to look at it——

Senator BUMPERS. Can you give me any historical basis for that statement?

Mr. DARMAN. Yes.

Senator BUMPERS. Do you remember a time in the history of this country where we have had a high growth rate that we did not also have inflation and high interest rates?

Mr. DARMAN. Yes, sir.

Senator BUMPERS. Either in the middle of it or following it?

Mr. DARMAN. Yes, yes, sir. The 1980's in which real growth has gone up, up, up, for what is now the longest period of sustained peacetime growth in our history, and interest rates have for most of the period gone right straight down and inflation has gone sharply down.

Senator BUMPERS. Oil prices went from \$40 to \$15 a barrel.

Mr. DARMAN. Well, you asked has it ever happened, and I am suggesting, sir, it has happened within our recent memory. I am not suggesting that it will happen necessarily again, or that we should wish it to happen for the same reasons. A good portion of that decline was thanks to excessively tight monetary policy, and some external events as you have suggested that have had mixed effects.

In the Southwest, the adverse effects of the energy price decline are serious. So I am not suggesting that we should do it again the same way, but I am suggesting that it was unpredicted and it has happened.

1981 TAX CUT—WAS IT TOO LARGE?

Senator BUMPERS. Well, Mr. Darman, you talk about the mistakes we made in 1981 on interest rates. The mistake we made in 1981 was the tax cut which David Stockman promised us was going to bring us so much revenue we would not be able to carry it to the vault. I remember candidate Reagan, we are going to cut taxes 30 percent, double defense spending, and balance the budget. As one old man in my State said, "What a dynamite idea. I wonder why nobody ever thought of that before."

Mr. DARMAN. September 9, 1980, then candidate Ronald Reagan put out an economic plan in which he tried to reconcile the competing views about whether supply side could or could not do this or that, and whether you could raise defense and cut taxes and still balance the budget and so on.

In that proposal which included both Kemp-Roth and some accelerated depreciation, back in September 9, 1980——

Senator BUMPERS. Plus safe harbor leasing and a whole host of other give-aways.

Mr. DARMAN. Well, a lot of those, sir, came in in the congressional bargaining process. But in the original Reagan proposal, he had revenue at 19.6 percent of GNP. Revenue today is at approximately 19.6 percent of GNP. So I do not think that what he was presuming at the start is radically at odds with what we have had.

It is true that in the congressional bargaining process, and I participated in it, and will share some of the responsibility for the fault, we produced a bill that over-achieved on the revenue side, and it came in with revenues as a percent of GNP, of about 18.5 percent. But we subsequently, less a year later, had TEFRA which was the largest tax increase in the history of the Congress which counter-balanced the prior over-correction, and that plus subsequent actions in Social Security and the 1984 and 1986 acts is why we are back to 19.6 percent of GNP on the revenue side.

Senator BUMPERS. Mr. Darman, I want to put on my epitaph most of the speech I made about an hour before we passed that tax cut in 1981. I was one of 11 Senators that was opposed to that. I said, you pass this tax bill and you are going to create deficits big enough to choke a mule, and we proceeded to pass it, and we created deficits big enough to choke a mule. I am going to go out on a limb and tell you again that I will predict that next year when you sit right in that chair, you will tell us, yes, you were off by somewhere between \$30 billion and \$60 billion on what the deficit was going to be for 1990 or for this year even. It will be some other extrinsic thing or it will be something you just did not anticipate.

The truth of the matter is the structural deficit, when you take Social Security and all those things, the structural deficit is probably \$240 billion for 1990. I wish I had longer to get into the relationship between the deficit and interest rates and the effects of our budget deficit on our trade deficit and all of those things, Mr. Darman. I will invite you over for lunch someday, and we will talk about it.

Mr. DARMAN. Yes, sir; I would look forward to also learning what you would propose in the current context in light of that.

Senator BUMPERS. I have got a lot of proposals. Just one question on tax increase. How do you feel about making everybody pay the 1.3 percent Medicare regardless of how much money they make, not just cut it off at \$49,000? You are talking about cutting Medicare by \$5 billion, and you are going to close about 22 hospitals in my State, and every other rural State in the Nation, West Virginia included, and why not pick up \$7 billion by letting people like me pay 1.3 percent which is the Medicare share of Social Security on all of our income? Do you oppose that?

Mr. DARMAN. Yes, I do, Senator.

Senator BUMPERS. Well, thank you.

The CHAIRMAN. Senator Specter. Senator Reid, would you come and chair the remainder of the hearings? Before you begin, Mr. Specter, if you will, without charging any time to you, Mr. Darman, would you supply the answers for the record to the following questions?

FURTHER RESIDUAL FREEZE ISSUES

No. 1, what amount of fiscal year 1989 budget authority is associated with the \$136 billion in fiscal year 1989 outlays for the programs which are proposed to be frozen in fiscal year 1990? I will submit these to you in writing.

No. 2, how much of an increase in budget authority would be required in fiscal year 1990 to provide for inflation or zero real growth for these programs, as you are recommending for national defense programs?

No. 3, please calculate the fiscal year 1990 outlay effect for this higher level of fiscal year 1990 budget authority for this group of programs. If you would provide the answers for the record?

Mr. DARMAN. Yes, sir, I will be happy to.

The CHAIRMAN. I will supply you with these questions in writing.

Let me thank you, Mr. Darman, for your appearance here today. I should say to the other members that Mr. Darman indicated that he had to meet the President at 2 p.m. today. He has had no opportunity for lunch, and yet he has sat patiently and answered questions, and I think we have had overall a very good hearing. I want to compliment the members as well for attending. We have had good attendance on both sides.

Senator SPECTER, you are next. Senator Reid, if you will proceed with further chairing of the committee. If other Senators have questions that they wish to submit, the responses will be included in the record.

Mr. DARMAN. Thank you very much, Mr. Chairman.

The CHAIRMAN. Thank you, Mr. Darman.

Mr. DARMAN. Thank you, sir.

The CHAIRMAN. Senator SPECTER.

Senator SPECTER. Thank you, Mr. Chairman. Before the chairman leaves with his compliments, a compliment is in order for the chairman himself. I was here at 10:58 a.m. when Senator Byrd, the chairman, gaveled this hearing to order. It is now 1:24 p.m. Both Director Darman and Senator Byrd have been very patient. I had absented myself for a time for Intelligence Committee hearings, and I will be relatively brief, Mr. Darman.

The CHAIRMAN. I thank the Senator for his kind comments.

FUNDING FOR THE HOMELESS

Senator SPECTER. Thank you, Senator Byrd. I have noted the intent of the President to increase certain funding on education and on drugs, to fully fund the McKinney Act, to create tax incentives, to stimulate growth in economically distressed areas, to maintain the \$1.6 billion for AIDS research. I say that. There are some proposed cuts on Amtrak and Urban Mass Transit Administration which I candidly think unlikely to go through with congressional approval. Those proposals have been made each year and while there have been some cuts over the course of the past 8 years, we have maintained most of Amtrak and Urban Mass Transit Administration.

The question I have, Mr. Darman, turns on the ability of the administration to increase these lines of expenditure and more pointedly what your expectation would be on what Secretary Kemp has

recently stated to be his intention to ask for an increased appropriation for the homeless.

On Thursday and Friday, Secretary Kemp came to Philadelphia and I and others toured the homeless areas with him, and it is really stark to see the homeless situation, to see hundreds of men in an intake center where they are suffering from alcoholism and drug abuse and to see women in shelters and to see so many people on the streets, and then to visit housing projects where there is an enormous problem of a shortage of housing and to contemplate how we are going to make all of the ends meet, realizing the Gramm-Rudman target and make all of these expenditures.

Perhaps let me start with the point of the question: What do you think the likelihood of success for Secretary Kemp would be in asking for administration approval for an increase in the budget for the homeless?

Mr. DARMAN. I have received several preliminary requests from him, and I am not aware of a significant increase that he has asked for under that heading. He already got—everyone did, not just Secretary Kemp, it is for general benefit—I think about a \$400 million increase for the homeless in budget authority for fiscal year 1990 and a \$150 million increase in outlays that fully funds the McKinney Act as liberally interpreted. Also included is a new \$50 million program—I think it is \$50 million program—a new categorical matching program for public/private partnerships. If he has an additional request, I of course will look at it on the merits. I do not know what it is.

Senator SPECTER. Well, the budget calls for funding of the McKinney of \$746 million which would be full funding for fiscal year 1990. It looks to me that it will be very difficult to make the kind of inroads on the problems of the homeless at that figure. It is very difficult to make any calculation as to what an adequate figure would be. Do you see any significant room for a significant increase in funding for the homeless?

Mr. DARMAN. One of the advantages of the much maligned black box is that it would allow us to look at the question of whether we should have a greater increase in that area, but it would have to be offset by something else. I do not yet know what the programmatic proposal would be. But obviously we would not be negatively disposed, but it would have to be offset.

Senator SPECTER. Mr. Darman, the problem of the homeless comes very close to the issue of housing, and when we were taking a look at the figures last year in the campaign situation and I and many others on our side of the aisle were making presentations in support of the Bush-Quayle ticket, and we took a look at the expenditures over the course of the past 8 years and projecting the figures in the best light possible, the one area where we really had a difficult time in measuring up was in the housing area, or let me say among the forensic difficulties which we faced that was the most acute.

I see that the fiscal year 1989 figures on housing are \$7.2 billion. In fiscal year 1990 is \$7.4 billion, and my question to you is in your position as Director of OMB, do you have an opportunity to get involved in the needs of the nation on housing? To what extent are

you personally familiar, if at all, with what the housing needs of the country are?

Mr. DARMAN. I am not anything remotely like an expert in this area. HUD is not one of the six departments I have served in, and I have never done much academic work in the field. I have, of course, sat through arguments on this for many, many years, and was in the administration back when Secretary Romney undertook a big study and have followed them since, but I do not pretend to be an expert.

Philosophically, I am more inclined toward the use of vouchers and income support measures than the direct provision of facilities/structures, and also I tend philosophically to favor measures that will promote home ownership, but that said, all we have done with this budget is say, let us take the means tested entitlement programs in the housing area and essentially hold them harmless.

That is basically what was done except for the additional element of a conversion of some elements to vouchers.

Senator REID. The Senator's time has expired. Senator Lautenberg.

Senator SPECTER. Thank you very much, Mr. Chairman. Thank you, Mr. Darman.

Mr. DARMAN. Thank you.

BUSH BUDGET FOR ENVIRONMENTAL PROGRAMS

Senator LAUTENBERG. Thank you very much, Mr. Chairman. Mr. Darman, last time we met, about a week ago in the Budget Committee I talked about transportation. We also talked about environment, and it will not surprise you to know that we have occasionally local interest issues or specific issues of concern that we focus on. What I would like to do right now is talk about the environmental issue or the environmental issues, and when we met last week, I pointed out to you a real problem with the EPA budget, particularly the clean water cuts. They were enormous.

You responded by saying that many in the environmental community expressed appreciation for the Reagan-Bush budget. Well, I am not sure who you were talking to, but I want to read to you from a letter I just got from some national environmental groups including Friends of the Earth and the Sierra Club and Environmental Safety.

I will just read a couple of paragraphs, and Mr. Chairman, I would ask unanimous consent that the full letter be placed in the record.

Senator REID. Without objection.

Senator LAUTENBERG. It is dated the 27th of February. It is addressed to me, and it says in the Senate Budget Committee's opening budget hearing on February 21 during testimony by Richard Darman you expressed concern about the impact of President Bush's proposed budget on the environment.

Mr. Darman responded that many in the environmental community have expressed appreciation for President Bush's budget. Now we are not taking Reilly to task here. He is a good loyal worker and supporter. That was not in the letter.

We believe that this statement creates a serious misperception that needs to be corrected. The letter says we wanted you to know that our organizations are extremely concerned about the impact President Bush's budget would have on the environment and particularly on the ability of EPA to carry out its work, and the letter goes on at some length.

Mr. Darman, it seems to me that the question is not whether some environmental groups support the budget because I do not see evidence of that. The question is will you be giving us resources to back up the President's environmental promises?

[The correspondence follows:]

February 27, 1989.

HON. FRANK LAUTENBERG,
U.S. Senate, Hart Senate Office Building, Washington, DC.

DEAR SENATOR LAUTENBERG: In the Senate Budget Committee's opening budget hearing on February 21, during testimony by Richard Darman, you expressed concern about the impact of President Bush's proposed budget on the environment. Mr. Darman responded that many in the environmental community have expressed appreciation for President Bush's budget.

We believe this statement created a serious misperception that needs to be corrected. We wanted you to know that our organizations are extremely concerned about the impact President Bush's budget would have on the environment, and particularly on the ability of the Environmental Protection Agency to carry out its work.

We had hoped President Bush would use the 1990 budget as the opportunity to restore the purchasing power EPA lost as a result of deep cuts in its budget early in the Reagan Administration—cuts that came at the same time EPA's responsibilities were more than doubling and were becoming much more complex.

Several groups have independently determined, based on the government's own workload numbers, that EPA's operating budget needs to be increased by 100 percent if it is to meet its existing commitments, much less address the new environmental problems facing us. Environmental leaders who had put together the "Blueprint for the Environment" transition document met with President Bush this fall and urged that he increase the operating budget by at least 20 percent a year (adjusted for inflation) for the next 5 years as a way of correcting the serious shortfall. Thirteen environmental organizations also urged significant increases over the levels in President Reagan's 1990 budget for EPA's operating programs and transmitted our concerns in a letter to President Bush and in a meeting with an Administration representative shortly before the budget was released.

However, far from beginning to restore EPA's budget to a level that would allow it to meet its expanded responsibilities, President Bush has proposed either (1) the same levels of funding proposed by President Reagan in his 1990 budget, (2) or freezing EPA at its 1989 outlay levels, with no increase for inflation. Neither of these options is acceptable if the Administration really wants to make protection of public health and the environment a priority.

President Reagan's 1990 budget included only a 1.6 percent, \$28 million increase (in 1989 dollars) for EPA's operating programs—leaving them with the purchasing power they had in 1978. Some operating programs would be cut below 1989 levels, and would receive as much as 35 percent fewer resources and 25 percent fewer staff than they had in 1981. That budget also contains a 38 percent cut below 1989 in the construction grants program to build and upgrade municipal sewage treatment plants and to support State water quality programs—which is a 50 percent cut below the \$2.4 billion the Administration committed when the shift to a State revolving fund was being negotiated with the States.

If the "flexible freeze" provisions of President Bush's budget are applied to EPA, the Superfund program would not receive the increase of more than \$600 million that was proposed in the Reagan budget, and operating programs would receive \$161 million (\$154 million in 1989 dollars), or 9 percent, less than they would under the Reagan budget proposals. This would leave them with less purchasing power than they had in 1977.

We hope this letter and more detailed analyses we are preparing on the impact on environmental programs of President Bush's current budget proposals will help clarify our position and our concerns. While we recognize the difficulty the deficit

presents, we think it would be disastrous to further reduce the already inadequate funding of the programs designed to protect public health and the environment from pollution, particularly when these programs have been responsible for driving more than \$70 billion a year of expenditures for pollution control in the private sector, and when we are becoming increasingly aware of the seriousness and irreversibility of so many environmental problems.

We would, of course, be glad to discuss these issues further with you if it would be helpful.

Sincerely,

ERIC DRAPER,
*Political Director,
Clean Water Action Project.*

BRENT BLACKWELDER,
*Vice President,
Environmental Policy Institute.*

WILLIAM DRAYTON,
Chair, Environmental Safety.

A. BLAKEMAN EARLY,
*Washington Representative,
Sierra Club.*

DAVID DIXON,
*Conservation Associate,
Izaak Walton League.*

DAVID K. BAKER,
*Political Director,
Friends of the Earth.*

RICK HIND,
*Environmental Program Director,
U.S. PIRG.*

Mr. DARMAN. I believe that we have proposed to do so, Senator. I do not have before me any proposal from Mr. Reilly to increase those resources. So while I am sure that the time will come when he is clearly the good guy and I am unquestionably the bad guy—

Senator LAUTENBERG. Start off with that premise.

Mr. DARMAN [continuing]. It has not come yet. I am sure that I may well be viewed institutionally as the bad guy on this issue. But at least the facts of the matter are at the moment I do not have a proposal from EPA for increased resources, and I am not specifically aware—except in the area that you point to, clean water, which is not a difference between Mr. Reilly and me, but which is a legitimate difference obviously between the Administration and many in the Congress—apart from that, I am not aware of where we are significantly remiss. If we are, I would be happy to take a look at it on the merits, at least as we judge them.

Senator LAUTENBERG. Yes. We are talking about \$750 million cut to clean water, sewage construction grants. That is from previous levels. That is not from the authorized level which was \$2.4 billion. That was after very strenuous negotiation between the Congress and the administration. It was designed to terminate essentially the clean water program.

It has a finite life at \$2.4 billion over about a 9-year period. So how do we reconcile the President's campaign commitment for a better environment with a cut for sewage construction grants of

three-quarters of a billion dollars, or \$1.2 billion if we take it from the authorized level?

Mr. DARMAN. It is my understanding that the original agreement, but I am not an authority on this, in 1972 was for a 10-year program which, if we are to be bound by such agreements, perhaps we should return to that agreement and get a refund for all that has been spent from 1982 to the present. I do not seriously propose that obviously.

Senator LAUTENBERG. I know you do not.

Mr. DARMAN. I do not expect that we would get it.

Senator LAUTENBERG. You seem to be ignoring that the reauthorization of the Clean Air Act took place over the President's objection, and we finally negotiated a compromise to continue the clean water program a lot more recently than 1972. In 1987, we did that.

Mr. DARMAN. Senator, if I could just explain one element of my own thinking on this. In looking at the various candidates for increases and looking at limited resources, I personally thought that the acid rain initiative, which costs some money, and Superfund were higher priority than the clean water initiative, and to some extent they offset each other.

I recognize that you never get credit for the positive. It is always how come there is this remaining negative, but I would at least ask that there be some slight recognition of the fact that here and there there are positive things that are not inconsequential.

Senator LAUTENBERG. Thanks, Mr. Darman, for spending some time with this.

Mr. DARMAN. Thank you, Senator.

Senator FEID. Senator Kerrey.

PRESIDENT'S BUDGET PROPOSAL

Senator KERREY. Director Darman, I do not know if I should be asking this question, or considering my junior position, but I have a genuine concern about the context of the proposal, the President's proposal. It seems to me that instead of asking the Congress to go home and sell the need for sacrifice to eliminate the fiscal deficit or at least to bring it down to give Alan Greenspan and the Federal Reserve some room to move, the President suggested that there was lots of new revenue. Mr. Greenspan was in front of the Budget Committee indicating that he fully intended to continue to raise interest rates if the deficit is not resolved.

But, instead of asking for shared sacrifice, the message that I heard from the President was we have \$80 billion of new money. We can bring the deficit down by 40 percent down. We've got a lot of new money to spend.

What that does, Mr. Darman, to me and obviously to the members of this committee and I suspect lots of other folks in the House of Representatives and the Senate, is it reduces us to our lowest common denominator. We have got to now fight for our fair share of the Federal pie. We have to take a look at the budget and discover if we have got our fair share instead of going home and saying to Nebraskans we are going to give up a little bit. It seems to me what I am reduced to is looking to see if we have gotten a fair deal.

I must tell you that in the process of going through the budget and looking at the line items for my State, I don't think I got a fair share. It did not surprise me, given that during the State of the Union Message where I heard superconducting super collider, and space station, semitech, deregulation of natural gas, increase expiration for oil and now from Senator Bumpers that we need \$200 million for SBA that is going to go to Texas and California. I hear the refrain "The Eyes of Texas Are Upon You."

I now find myself in a position much like that described by Senator Leahy: Agriculture subsidies were cut, Medicare reductions were made, and the question is, in the process of looking at this wonderland that you see in the current services budget, in the process of looking at that wonderland, did you see other habits of the mind like Gramm-Rudman-Hollings itself or perhaps even campaign documents that promised not to raise taxes or promised to spend more money in education and all sorts of other things, did you see other habits that would cause you to conclude that the message should have been different? Should have taken that \$80 billion in new money and given the Federal Reserve some room to move by reducing the budget by that amount?

Mr. DARMAN. Well, Senator, we proposed to reduce the budget deficit by about \$70 billion and a little, which is not an insignificant amount. On the other hand, an \$80 billion increase—it is on the order of \$85 billion. CBO says a little bit higher—that is larger than the GNP of 137 countries. It is not necessarily a small amount.

On the tactical question of whether one should step forward and say the sky is falling, let us all share the pain, or do it in the way that we did, I just think that ours is a fair representation of reality. This is a serious problem. On the other hand, it is manageable if we all work together constructively which is what we are trying to get done.

If we fail to do it, I may say, we do have the Gramm-Rudman-Hollings law which is law, and the sequester is a failsafe. It is a very clumsy one. But it is the law.

Senator KERREY. What is there about Gramm-Rudman-Hollings that you find to be more sacred than the constitution? I mean you propose—

Mr. DARMAN. I do not find it to be more sacred.

Senator KERREY. You propose some changes in the Constitution without any difficulty at all. You propose some other changes in the process. What is there about Gramm-Rudman-Hollings that is so sacred?

Mr. DARMAN. It is a practical issue, Senator. It is not that it so sacred. I have testified at length as to what I think is wrong with it. But it is the law, and to change it you would need agreement in both Houses and in the executive branch. And if you think of it this way, can you imagine a context in which we all agree to change Gramm-Rudman where we could not agree on doing something substantive about deficit reduction?

I personally cannot. If we can achieve the agreement that would be necessary to change Gramm-Rudman, then we ought to use that capacity to reach agreement in order to get something serious done.

Senator KERREY. Please understand that my question is offered in a constructive way. I do not think that the context has to be "the sky is falling." What I am saying is that when you stand before a body that by definition is undisciplined, and say that we got \$80 billion of money, that we can reduce the deficit easily and that we have all kinds of new money to spend that you do, indeed, reduce us to having to fight for our fair share. That, in fact, is what you see happening.

I heard the President campaigning like I did. But I have come in and looked at the problem, and it is more serious than I thought. You have rushed, I think correctly, to solve the problems of the S&L's, and I just respectfully suggest, that more aggressive action is needed.

It is not "sky is falling." The economy is still strong. The people, I think, are prepared to act, and I just find myself in a position of having to do things that I think are not worthy of the times that we are in right now—which is going through the budget and trying to figure out did Nebraska get its fair share of the deal.

Mr. DARMAN. One of my predecessors, who is a friend of mine but much maligned, David Stockman, had an enormous amount of notoriety at exactly this point in tenure by saying that we were dealing with Dunkirk. So we have seen that approach attempted. I am not saying it is right or wrong. I do not think that the historical experience of claiming that we are dealing with Dunkirk produced all that much on the saving side.

I think that the process of getting an informal, constructive negotiation going where people do what they think is right and come back to members and to the administration and say, we have looked things over, this is what we all take to be in the best interest, we are prepared to share the credit, share the blame, do what is right, that that tends to work a little better.

It did work with the Social Security compromise in 1982 and 1983, when no one thought it could be done. Not no one, but very few people. And it worked with tax reform which people wrote off as dead more times than you can imagine, and ended up passing the Senate Finance Committee, after it was declared dead, 20 to nothing. It did not happen by people saying we have a binary choice between what the administration has presented and nothing or outbidding the administration.

It happened because after we got over this initial stage which we are in now, and in which it is customary to have me come up here as OMB director and get berated a little bit and have other things like that happen, we get past that, and eventually we get down to business, and hopefully in a constructive spirit, we collectively put together what we think is the best thing for the country, and then sell it as such.

The President has made the first move. I am attempting to be cooperative. At some stage the Congress will have to decide whether it wants to make a move on its own or whether it wants to work with us in a bipartisan spirit. I am assuming it will be the latter, and when it is that you will not see the lowest common denominator. You will see people rise to the occasion.

Senator KERREY. But if we are, in fact, going to be able to go home and sell reductions, it has got to be, I think in a spirit that

says this is what is going to happen if we do. It is very much like dieting, Mr. Darman. We have to get a picture of ourselves somewhat healthier. I do not have to have gloom and doom. But if you tell me that I have 25 million calories for the rest of my life, I really do not want to save up my calories. I want to have 3,500 calorie days now.

I mean it seems to me that the context of the request that the President has made to us is very important because what you have seen here, I think, this morning and now part of this afternoon could still be changed.

Senator REID. The Senator's time has expired. I know that you have a meeting, and I will be as quick as possible, Mr. Darman.

NATIONAL CRITICAL MATERIALS CONFERENCE

Mr. DARMAN. Thank you.

Senator REID. I waited around all day because I wrote you a letter I want answered. On January 10, I wrote you a letter, and I know those were times of change and everything, but if you would dig around down in your office you will find it. I wrote a letter regarding my concerns about a proposal contained in the fiscal year 1990 budget to eliminate funding for the National Critical Materials Council. I think that when we talk about things important to the country, we must talk about critical materials. We have waited around now for 15 years to set a national energy policy, and we do not have one. That is not your fault. I recognize that. It is our fault, Congress's fault as much as anyone elses.

But we have a critical materials problem. I have worked very hard to get this council going. I have put an amendment on the Trade Bill which passed easily, but we cannot get the administration interested. If the letter is not expressive enough, I would be happy to sit down with you or anyone you designate to indicate to you the importance of this and why I think you should give it favorable consideration. So if you would answer my letter at your earliest convenience, I would appreciate it. It is overdue now.

Mr. DARMAN. I would, Senator. I apologize. But if it were January 10, at that point I did not have a fixed office address and it may well have been lost. I apologize.

Senator REID. I understand that. I explain to people all the time about mail that gets lost.

Mr. DARMAN. But that was a peculiar situation. I was between jobs.

Senator REID. OK. The last thing is you also have received a letter recently from both me and my colleagues, a number of my colleagues, about concern for funding for emergency fire-fighting. The Forest Service proposed to meet this expense by transferring unobligated fiscal year 1989 funds appropriated for land acquisition. Without going into a lot of detail, that is another thing to which I would like to draw your attention. Lake Tahoe is a very fragile lake.

Mr. DARMAN. We stopped that.

Senator REID. OK.

Mr. DARMAN. I did learn of that, and I did stop that. I do not have the alternative solution worked out yet, and there is going to have to be one. But we have at least— you mean the \$55 million?

Senator REID. Right.

Mr. DARMAN. That is stopped.

SUBMITTED QUESTIONS

Senator REID. We are not going to not ask you any more questions. I have others to ask, but I know you have to be at the White House. Without objection, I ask these questions be submitted for the record for the following members: Senators Mikulski, DeConcini, and Harkin. Other members may also have questions for written response to you, Mr. Darman.

[The following questions were not asked at the hearing, but were submitted to the office for response subsequent to the hearing:]

QUESTION SUBMITTED BY SENATOR ROBERT C. BYRD

IMPACT OF REAL FREEZE ON THE RESIDUAL

Question. One, what amount of fiscal year 1989 budget authority is associated with the \$136 billion in fiscal year 1989 outlays for the programs which are proposed to be frozen in fiscal year 1990? I will submit these to you in writing.

Number two, how much of an increase in budget authority would be required in fiscal year 1990 to provide for inflation or zero real growth for these programs, as you are recommending for national defense programs?

Number three, please calculate the fiscal year 1990 outlay effect for this higher level of fiscal year 1990 budget authority for this group of programs. If you would provide the answers for the record?

Answer. The residual includes outlays associated with \$131.5 billion in 1989 budget authority. If budget authority were allowed to increase to provide for zero real growth for these programs, budget authority for 1990 would be \$139.4 billion, or \$7.8 billion above the 1989 level. This calculation assumes that the mandatory programs in the residual would continue at current law. Discretionary program levels are assumed to be frozen in real terms. An additional \$9.6 billion in outlays would result from the increase in program level.

The year-to-year change in outlays is greater than the year-to-year change in budget authority for several reasons. First, under current law for several mandatory programs in the residual, outlays increase more than budget authority. For conservation reserve and Postal Service, for example, under current law outlays increase \$2.5 billion but budget authority increases only \$1.0 billion. Second, total outlays for the programs in the residual category are frozen in nominal terms. When the freeze is defined in real terms on budget authority instead, the year-to-year outlay increase reflects both the increase in outlays from prior year authority that is occurring under current law and an increase in outlays from new authority resulting from an inflation adjustment. When total outlays are frozen, new outlays and thus new authority must actually decline from year-to-year.

QUESTIONS SUBMITTED BY SENATOR ERNEST F.
HOLLINGS

U.N. PEACEKEEPING FORCES

Question. In mid 1988 we had peace breaking out all over the world with the Russians beginning their withdrawal from Afghanistan, Iraq and Iran agreeing to a cease fire, and a settlement between the competing forces in Namibia and Angola. Late in the last session the House Passed H.R. 5551 which would have permitted the President to transfer Department of Defense and Foreign Assistance funds to the Department of State for the United States' assessment supporting United Nations peacekeeping forces in those areas. Unfortunately, that bill got involved with some controversial foreign policy matters and was not approved.

The appendix to President Reagan's 1990 budget includes a 1989 supplemental request on page II-10 similar to the legislation approved by the House last year. The proposed supplemental would allow the President to transfer to the Department of State's International Peacekeeping account up to \$125,000,000 from pre-1989 appropriations of the Department of Defense or from any available appropriations in the foreign operations appropriations acts.

The Secretary-General of the United Nations has been complaining that the major donor nations have not paid their assessments for peacekeeping. Certainly we want to do our part to achieve stability in these areas but we are also confronted with the requirement to achieve stability in our budget.

The Balanced Budget and Deficit Control Act, as amended, limited the deficit for fiscal year 1989 to \$136 billion. While I personally believe the 1989 deficit will be \$175 billion, even President Reagan's budget says we will have a 1989 deficit of \$161.5 billion, which OMB has now increased to \$164 billion. Accordingly, any new spending proposals must be outlay neutral or they are subject to a point of order in the Senate. The Congressional Budget Office says the requested supplemental is not outlay neutral by \$107,000,000.

What steps is the Administration taking to make this supplemental proposal outlay neutral, or how do you expect us to proceed with this proposal?

Answer. The costs of new UN peacekeeping initiatives in Namibia/Angola and the Persian Gulf are considerable. The Administration's proposal to fund the U.S. share of the costs of these operations through a transfer of up to \$125 million involves moving funds from slower spending Defense Department accounts to the fast spending State Department peacekeeping account. The concerned agencies are currently working to identify the specific accounts from which funds will be transferred so that the precise outlay impact can be determined. The Administration will propose the necessary offsets.

ASSETS FORFEITURE FUND

Question. In the Crime Control Act of 1984, Congress established the Assets Forfeiture Fund to account for the assets seized from the criminals and for their dispository. The following is a history of the annual receipts of the fund.

History of Assets Forfeiture Fund Collections (\$ in millions)

<u>Fiscal Year</u>	<u>Amount</u>
1985	\$27.2
1986	93.7
1987	177.6
1988	207.3
1989 (est.)	450.0
1990 (est.)	470.0

Mr. Darman, I am interested in the reason why the FY 1990 Department of Justice budget request shows only a \$20 million growth in Asset Forefeiture collections. This is almost unimaginable when we compare the enormous growth -- some \$242.7 million -- in collections from 1988 to 1989. Particularly since this increase in collections was before the 175 new attorneys and 175 support staff were hired solely for assets forfeiture civil enforcement as a result of the recently enacted Omnibus Anti-Drug Abuse Act of 1988. Congress expected substantial growth in the fund due to the greater collection effort which, in turn, would support greater law enforcement, particularly with respect to drugs.

Please don't refer us to the Department of Justice as they have already told us that the \$470 million estimate for 1990 was an "arbitrary" amount established by the Office of Mangement and Budget (OMB).

Answer. The Assets Forfeiture Fund is a volatile account. Receipts are difficult to estimate because they depend on law enforcement actions taken in prior years which are often subject to lengthy court procedures. It is also not always possible to determine how much money a given asset will bring when it is sold at auction. The following table compares the original and revised estimated receipts with those actually collected. As the table shows, estimating receipts has not been an exact science.

FY	Estimate	(\$ in millions)		Actual
		Revised Est. (FY+1)		
1985		\$150		\$27
1986	\$150	\$105		\$94
1987	\$145	\$140		\$178
1988	\$140	\$271		\$207
1989	\$450	\$450		N/A
1990	\$470	N/A		N/A

For every year except 1989, the estimates were revised. Furthermore, in every year the actual collections deviated substantially from even the revised estimate.

The Marshals Service expects to improve on their estimates of receipts into the fund. The 1988 Anti-Drug Abuse Act provides for expedited contracting procedures, and increased experience with the program will no doubt increase efficiency. Yet estimates will remain imprecise.

The question correctly states the rationale for the estimated large increase in receipts in 1989. The Drug Act added 175 positions, in attorneys and support, to the U.S. Attorneys for assets forfeiture. The estimates were that each FTE devoted to assets forfeiture brought \$2.5 million into the fund. Assuming that the additional staff could not be brought on board until FY 1989 was half over, the Attorneys estimated that an additional \$240 million would be collected. (96 FTE times 2.5 million per FTE equals \$240 million.)

In retrospect, using the \$2.5 million per FTE may have been an overly optimistic estimate. By 1987, the year on which the \$2.5 million per FTE multiplier is based, the program had achieved a certain maturity. To have assumed that new attorneys could work at the same efficiency may have been overly optimistic.

The seemingly low 1990 estimated receipts are based, in part, on these reservations. In addition, the estimate stems from a more careful review of properties which will be liquidated in 1990. The estimate is not an "arbitrary" amount, but the result of a conservative approach to formulating out-year estimates for a program in which such estimates have proved troublesome in the past. Collections above the \$150 million designated to the Office of National Drug Control Policy go to the Treasury for deficit reduction. Thus, to have not made a conservative estimate, given the present budgetary climate, would have been inappropriate.

SBA GUARANTEED BUSINESS LOANS

Question. We are informed that as of December 31, 1988, the Small Business Administration Approved \$604,000,000 or 99.8% of the 1st quarter's allocation for general business guaranteed loans. In addition, SBA went into the second quarter with an \$85 million backlog for such loans. To meet this demand the SBA has been juggling the allocations between the various offices.

We understand that some of this demand for guaranteed general business loans can be met by reprogramming funds originally allocated for development company and small business investment company loans. In fact, in November, SBA proposed reprogramming of \$200,000,000 from these allocations to meet the demand in the general business loans. OMB turned this down as they apparently would prefer to "go to bed" with a \$200,000,000 unused next September 30th instead of meeting the demonstrated demand of American small business.

Mr. Darman, all of this comes from the same account, so there is no scorekeeping impact. Why then do the OMB bureaucrats turn their backs on the legitimate needs of small business by not reallocating the necessary funds?

Answer. OMB is aware that the Small Business Administration's Section 7(a) general business guaranteed loan program has experienced increased demand during FY 1989.

OMB has been monitoring developments in this program. We have reviewed and approved SBA's request to reprogram funds from other SBA guarantee programs which are experiencing lower than anticipated demand to the general business guaranteed loan program. Specifically, SBA will reallocate \$85 million in loan

guarantee authority from the Development Company program and \$115 million in loan guarantee authority from the Investment Company program to meet demand in the Section 7(a) program. This will bring the total guarantee authority for the general business program to \$2.6 billion for FY 1989.

Approval of the reprogramming involves a reapportionment of funds within the total guarantee levels set in appropriations report language.

QUESTIONS SUBMITTED BY SENATOR QUENTIN N.
BURDICK

CONSERVATION RESERVE PROGRAM

Question. With regard to the Conservation Reserve Program, the Food Security Act of 1985 requires that at least 40 million acres be entered by the end of 1990. Your budget apparently contains sufficient funds in terms of budget authority to accomplish this goal. However, you have underestimated the outlays needed, and the amount you assumed--\$1.771 billion--would only provide for the entrance of 35 million acres. USDA estimates that \$2.039 is needed.

Why?

Answer. USDA's estimated outlays for 1990 are consistent with the Department's 1990 request for budget authority for a 40 million acre reserve.

Question. Is it your intention to offer legislation to change the goal of the CRP?

Answer. No, it is not our intention to offer legislation to change the goal of the CRP. This is the reason we proposed sufficient BA to meet the minimum number of acres mandated by law.

Question. If not, why haven't you assumed enough outlays in your budget to comply with the law?

Answer. Outlays are based on anticipated program participation levels, not budget resources made available by law. Our analysis indicates program participation in the CRP will be 35 million by end of 1990. Outlays for 35 million acres will cover anticipated program needs.

Question. What would be the proper outlay figure to go with 40 million acres?

Answer. The outlay figure associated with a 40 million acre reserve would be \$2.039 billion.

Question. What would be the budget authority and outlay figures for 45 million acres--the maximum acreage allowed under the law?

Answer. Assuming 45 million acres, the maximum allowed by law, required BA would be \$1.634 billion and outlays would be \$2.397.

FARM CREDIT SYSTEM

Question. With regard to the Farm Credit System Financial Assistance Corporation, it is now OMB's position that its expenses are on budget where it was previously off-budget.

What is the logic for this change?

Answer. Section 646 of the 1989 Rural Development, Agriculture and Related Agencies Appropriation Act, directs the return at the beginning of FY 1990 of Farm Credit System institutions' assessments which were used to buy stock in the Financial Assistance Corporation (FAC). These assessments not only represent the nominal private ownership of FAC which permitted the FAC non-budgetary status, but also represent the private at-risk capital which is the only private safeguard against the federal guarantee of FAC obligations. Section 646 significantly reduces private sector participation in FAC's future success or failure. In addition, Section 646 is totally in violation of the agreement we negotiated in good faith with the Congress that was embodied in the Agriculture Credit Act of 1987.

Therefore, unless legislation is enacted repealing Section 646, FAC outlays will be scored on-budget beginning in 1990 when the assessments would be returned.

Question. The FAC is authorized to issue up to \$4 billion in debt and Treasury is paying all of the interest in the first 5 years. Yet, you indicate that a partial rebate of the mere \$177 million paid in by institutions is enough to change the status of this fund and causes it to be on-budget. It would appear that the original characterization of FAC being off-budget was made on grounds both political and expedient.

Isn't your decision to put it on-budget now also both political and expedient?

Answer. No. We are as concerned as Congress is in reaching deficit reduction targets, and towards that end adding approximately \$650 million in 1990 FAC outlays will make our job that much harder. There is nothing 'political' about requiring sufficient private ownership to justify non-budgetary status for an institution created by the federal government. Our decision on FAC is based on budgetary scoring principles, which the Congressional Budget Office agrees with.

Question. Isn't this just an attempt to force Congress to repeal the Bumpers' legislation? (The President's budget states that the Administration will propose to repeal the Bumpers' legislation.)

Answer. No, we do not propose to score FAC on-budget simply as an incentive to repeal Section 646; Our scoring is based on the effect of the Section on the private at-risk capital contribution embodied in the original Act. If action is not taken to repeal Section 646, or otherwise revert to the original assessment formula, FAC will be scored on-budget beginning in FY 1990.

Question. Are you being consistent with your proposal to bail out the savings and loan industry where the cost of the bailout will be \$126 billion and only \$39 billion of that will be on budget?

Answer. There are distinct differences between the proposed structure of the FSLIC's REFCORP and the FAC structure (after Section 646 takes effect) that justify different budgetary treatment. FAC debt is explicitly guaranteed by the U.S. Government as to timely payment of principal and interest, where REFCORP's would have no such federal guarantee of principal. FAC debt is therefore more closely allied with Treasury security status than REFCORP's would be. Principal of REFCORP debt would be defeased by an up-front purchase of zero-coupon bonds, using an estimated \$6 billion contribution from the Federal Home Loan Banks and private savings and loan institutions. FAC debt has no privately-contributed principal defeasance. These differences are sufficient for REFCORP to be scored as non-budgetary. However, if subsequent to the REFCORP proposal's enactment legislation similar to Section 646 were to be enacted, which would alter the formula for private S & L contributions, REFCORP's budgetary status would likewise be subject to review.

FOOD AND DRUG ADMINISTRATION USER FEES

Question. User fees were suggested by President Reagan in recent years as a means of funding the operations of the Food and Drug Administration, but were rejected by Congress. Critics argue that user fees would have a deleterious effect on segments of our population that depend most on safe, effective consumer products.

First, it is charged that significant research and development could be stymied since small businesses are largely responsible for new discoveries in biotechnology, pharmaceuticals, medical devices, etc.

would be unable to afford user fees. To them, user fees would constitute an unfair form of "double taxation" on approval processes they are required to meet by law.

Second, if industry cannot meet the costs of user fees, it is argued that consumers who rely most on medical and scientific advances would be forced to pay indirectly for FDA approvals. Senior citizens, for example, would become "captive audience" to more costly prescription products -- costs increased merely to defray the expense of user fees.

Would you please comment on these allegations by explaining for the Committee whether you believe FDA user fees would adversely affect R & D efforts or cause an increase in consumer products?

Answer. FDA user fees would not adversely affect industry research and development or product availability. Among FDA's many activities, the potential exists to collect a total of \$136 million in user fees annually. (See attached list) In recommending FY 1990 FDA user fee collections of \$100 million, allowances were made for \$36 million in exemptions for drugs for life-threatening illnesses, inability to pay, and other humanitarian reasons.

Moreover, the FDA user fee is certainly not a tax. Taxes are general revenues that are not linked to any specific, identifiable good or service. The proposed FDA user fees are associated with specific services provided to identifiable manufacturers. The user charges are designed to capture partially the substantial private benefit from FDA's safety and efficacy seal-of-approval.

For example, a 1988 FDA analysis found that the length of new drug premarketing review time has substantial economic costs to industry, as well as costs to the public in terms of delayed access to the drug. For the pharmaceutical industry, if drug application review times are reduced from 24 to 12 months, FDA estimates that industry profits will increase by \$74 million annually. For the medical device industry, FDA estimates that a one month change in the length of device review results in \$100 million in additional industry profits.

When you consider the Federal commitment to improving the new product approval process, the beneficial effect on industry becomes more clear. The Federal government has accelerated new product approvals in FDA through reduced regulatory and

paperwork burden, automated data processing, expanded basic research into risk assessment models, earlier contact between FDA and prospective new drug approval applicants, and addition of new budget authority and FTEs. Between FY 1980 and FY 1988, total funding for the FDA's Centers for Drugs and Biologics and Medical Devices increased by 72 percent from \$142 million to \$244 million.

For new drug applications, review times have decreased from an average 34 months in FY 1980 to an average of 24 months in FY 1988 -- a decrease of 29 percent. Using the FDA methodology, the reduction in review time of 10 months has increased annual pharmaceutical industry profits by approximately \$62 million. For new medical device premarket approval applications, review times decreased from an average of 13 months in FY 1986 to an average of 11 months in FY 1988 a 15 percent decrease. FDA methodology suggests that the reduction in device review time of 2 months has increased annual medical device industry profits by approximately \$200 million.

As this information indicates, the Federal government has committed new resources and increased productivity to accelerate product approvals, and private corporations have directly benefited from early marketing of their products as well as from reduced liability from Federal quality and safety guarantees. User fees are proposed to capture a portion of the private benefit to achieve greater equity.

Finally, user fees adopted for similar activities in other departments have not adversely affected industry. For example, the USDA Agriculture Marketing Service provides inspection, grading and classing services for fruits, vegetables, dairy products, meat, poultry, cotton and tobacco, which are fully funded through user fees. In FY 1988, \$39 million in user fee collections directly supported these activities.

ACTIVITIES WITH POTENTIAL FOR USER FEES

FOOD AND DRUG ADMINISTRATION

- o Radiological Product Evaluation: Potential for \$15.4 million annually;
- o Medical Device Product Evaluation: Potential for \$12.1 million annually;
- o Medical and Radiological Product Premarket Approval Review (applications and supplements) and Manufacturing Establishment Inspections: Potential for \$7 million annually.
- o Biological Product License Application Reviews: Potential for \$4.4 million annually;
- o Animal Drug Manufacturing Establishment and Feed Mill Inspections: Potential for \$2.2 million annually;
- o Medicated Feed Applications Review and Processing: Potential for \$1.5 million annually;
- o Human New Drug Application Product Reviews: Potential for \$29 million annually;
- o Color Additive Application Review Fees: Potential for \$1 million annually;
- o Cosmetic Manufacturing Establishment Inspections: Potential for \$3 million annually;
- o Cosmetic Sample Examination Inspection and Analysis: Potential for \$1 million annually;
- o Domestic Food Sample Examinations: Potential for \$2.3 million annually;
- o Food Additives Application Fee: Potential for \$17.6 million annually;
- o Animal Drug Applications: Potential for \$12.1 million annually;
- o Import Inspections and Monitoring: Potential for \$14.3 million annually;
- o Manufacturing Establishment Licensing: Potential for \$11.1 million annually;
- o Drug Export Review: Potential for \$1.5 million annually.

Question. It has also been suggested that the budget presents an unrealistic estimate of its 1990 user fee collections. Do you realistically believe \$100,000,000 could be collected from user fees in 1990 alone?

Answer. Certainly. As noted in response to an earlier question, the potential exists to collect a total of \$136 million in user fees annually from over 16 separate FDA's activities. In recommending FY 1990 FDA user fee collections of \$100 million, allowances were made for \$36 million in exemptions for drugs for life-threatening illnesses, inability to pay, and other humanitarian reasons.

The Congressional Budget Office included a proposal for collecting FDA new drug approval user fees totalling \$100 million in FY 1988, \$205 million in FY 1989 and over \$300 million annually for FY 1990 through FY 1992, in the January 1987 report, Reducing the Deficit: Spending and Revenue Options.

Additionally, the Senate Budget Committee included a proposal (recommended by the Senate Labor and Human Resources Committee) to collect \$80 million for FY 1988 and \$110 million annually from FY 1989 through FY 1991 in its version of the FY 1988 Budget Resolution.

The \$100 million FDA user fee estimate included in the President's FY 1990 Budget generally agrees with these other estimates.

Question. Would these funds be placed in a special fund for use by FDA or used to replenish the general fund? If such collections were inadequate, how would the shortfall be corrected during the course of the fiscal year?

Answer. As included in the FY 1990 Reagan Budget, the \$100 million in FDA user fees would directly support the activities for which they were collected, as well as replenish the general fund. For example, 10 percent of the funds collected would be additive to FDA obligational authority, while 90 percent would replenish the general fund.

As included in the Bush FY 1990 Budget, the details of the fund could take several forms and are open to negotiations between the Administration and Congress. For example, a revolving fund could be established to

support all or part of each activity for which a fee would be collected. This is similar to the current FDA Revolving Fund for Color Certification which is fully funded through user fees.

Although not expected, a number of options exist for addressing a shortfall. For example, FDA could use a portion of its contingency fund. Alternatively, the FDA Commissioner could reallocate among activities to meet health emergencies or temporary shortfalls.

QUESTIONS SUBMITTED BY SENATOR PATRICK J. LEAHY

FOREIGN AFFAIRS

Question. One of the most glaring omissions in the President Reagan's budget request was to fail to provide enough funding to cover the Refugee and Migration account. Independent estimates are that we are going to need at least \$100 million more than the Reagan request of \$371 million--and the Administration knew that when it submitted the request.

This is a tragic human problem, with refugee populations building up in centers and detention camps around the world. How will the Bush Administration handle this shortfall in the request? Will you revise it to make it more realistic, or will you at least advise us what other programs we should cut to find the funds to meet these urgent needs?

Answer. In support of the leading role the United States plays in the international community on refugee issues, the FY 1990 Reagan budget request included \$370 million for the Migration and Refugee Assistance Program. These funds were requested to provide life-sustaining assistance to refugees abroad and for the admission of up to 84,000 refugees and Amerasian immigrants to the United States in 1990. The FY 1990 budget request also included \$10 million to replenish the refugee emergency fund.

The recent increase in Soviet emigration has created new admissions needs. We are acting quickly and responsively to determine how we can best meet these needs for 1989.

Right now, the Reagan budget is considered the starting point for the FY 1990 budget negotiations. Any revision to the FY 1990 budget request would come about as a result of the Presidentially-directed NSC review of foreign policy and national security challenges (which will be completed within 90 days)

Question. One of the most controversial issues for the Foreign Operations Subcommittee this year will be the EXIM Bank. The Reagan budget request zeroed the direct loan program, funded last year at \$695 million. According to your letter to Congressman Michel, EXIM is now in the flexible freeze pool that is subject to cuts. What precisely is the Administration's position on EXIM Bank now--does the President propose to eliminate the direct loan program or not? If not, what is his position on funding for that program, and what

would the impact on the FY 1990 request for Foreign Operations be of funding EXIM Bank direct loans?

Answer. The 1990 Reagan budget proposed moving to a "guarantees only" Export-Import Bank because of significant Reagan Administration successes since 1980 in negotiating international agreements to reduce export credit subsidies of the industrialized countries. The Reagan budget stated that the Bank's broad range of loan guarantee and insurance programs could provide comprehensive financial support for U.S. exporters. Consequently, it provided for a substantial increase in authority to issue guarantees and insurance. With respect to President Bush's proposals, however, the Export-Import Bank is included in a large group of programs that, in the aggregate, are frozen at the 1989 levels. The President is prepared to negotiate with the Congress in good faith on the amount available for any particular program within the overall total. For the Export-Import Bank, we will start the negotiations with a predisposition that direct loans are still needed. We are not, however, in a position at this time to assign levels to individual programs such as the Export-Import Bank.

Question. A similar example is US arrearages to the Multilateral Banks. The Administration is requesting an increase of over \$300 million for arrearages. Yet, if Congress is to find this money within the level requested for 1990, it must come from some other program. Will the Administration give us its views on what should be cut so the United States can make good its arrearages to the Multilateral Development Banks.

Answer. The amount requested by the Administration for the Multilateral Development Banks as contained in the FY 1990 Reagan budget includes the \$300 million for arrearages. While the total amount of U.S. arrearages outstanding to the Banks exceeds the \$300 million requested in FY 1990, this was the maximum amount that the Reagan Administration felt could be sought to address the international commitments given the budgetary constraints and pressing needs in other parts of the international affairs budget. Any changes to this amount by the Administration would occur as a result of the review of foreign policy that the President has requested.

COMMODITY PROGRAM LEGISLATION

Question. Mr. Darman, in response to my question during the hearing on February 28th, you said that you originally thought that there should not be cuts in

commodity programs in Fiscal Year 1990. Then you went on to say that, after some thought, and in recognition of the fact that 1990 is an election year, it might be appropriate for Congress to renew the commodity programs in 1989, rather than waiting until 1990.

In his confirmation hearing before the Agriculture Committee, Secretary Yeutter suggested that Congress might want to delay drafting new commodity program legislation until after the current round of trade talks is completed. Specifically, the Secretary said in his opening statement, "We simply cannot rationally construct farm legislation for the '90's until we know the outcome of the Uruguay Round."

Are you speaking for the the Administration now in terms of the timing of new commodity program legislation?

Further if Congress were to wait until 1990 to present new commodity program legislation to the President, are you saying that the Administration would propose no cuts in commodity program outlays before that time?

Answer. It is too soon to be specific about the time of new commodity program legislation, but Commodity Credit Corporation outlays must be reduced if the GRH deficit target of \$100 billion in 1990 is to be achieved. The 1985 Food Security Act does not expire until December, 1990, and it will be too late to reduce FY 1990 CCC outlays if we wait until then to make changes in farm programs. Any delay in reducing CCC spending could be a contributory factor leading to a 1990 sequester, which would mean across the board cuts in agriculture. A sequester would not only reduce spending by an amount comparable to our Budget proposals, but -- because it is arbitrary -- would jeopardize high priority agriculture programs like research initiatives in water quality and food safety. Secretary Yeutter has been charged by the President to work with Congress in developing specific means of reducing farm price and income supports in FY 1990.

QUESTIONS SUBMITTED BY SENATOR DENNIS DeCONCINI

INTERNAL REVENUE SERVICE FY 1990 BUDGET

Question. The FY 90 Reagan budget included an increase of \$289 million for the IRS. That increase would have allowed continued modernization of the automated processing of tax returns, improved taxpayer service, and an enhanced revenue initiative for the IRS. That initiative would have cost \$55 million and generated revenues of \$318 million in FY 90.

I am not sure what impact the so-called "flexible freeze" will have on the IRS budget for FY 90. Can you tell me whether or not the Bush budget includes a flexible freeze for the IRS in FY 90?

If it does, it is my understanding that IRS would have to reduce 4,925 positions. This would not only eliminate the revenue initiatives and other enhancements in taxpayers service, but would eliminate the inflationary increase. I am told this would have a combined revenue loss of about \$645 million. Is this a wise move under the current deficit assumptions?

Answer. The Internal Revenue Service (IRS) budget, with the exception of about \$70 million devoted to anti-drug initiatives, is part of the residual freeze in the Bush budget. However, this does not necessarily mean that the IRS budget would be constrained to the 1989 level. The President has emphasized that the freeze category is flexible, allowing some programs to increase while others are reduced.

The IRS would need additional funding above a 1989 freeze level to collect the \$318 million in receipts contained in the budget. The \$289 million increase for the IRS in the Reagan budget would have funded 2,052 additional FTE in FY 1990 above the FY 1989 level. Clearly if no increase were provided, these FTE would not be realized. In addition, further FTE reductions likely would be required to absorb mandatory (inflationary) cost increases. Whether or not these additional FTE reductions would cause the government to lose revenues would depend on which programs were reduced to accommodate the FTE decrease.

INVESTMENT IN MANAGEMENT IMPROVEMENT

Question. In FY 89, the Congress provided \$1 million under the account of "Expenses of Management Improvement" within the Executive Office of the President for the acquisition of an office automation

system for the Office of Management and Budget. The Reagan Budget for FY 90 proposes to change the name of that account to "Investment in Management Improvement" and has requested some \$83.9 million to improve financial, credit and quality management of the Federal Government.

I notice this item is being shown in the OMB tables provided to the Committee as being spread over several different budget functions, yet it has been requested under one account under the Executive Office of the President, which comes under the Treasury Subcommittee, which I chair.

If this \$83.9 million is going to be allocated to various Federal programs, why is it being requested under one account?

Answer. It is being requested in one account so that OMB can better control the prudent allocation of the money. The funds will be distributed to individual agencies for specific projects contingent upon the agency's: (a) submitting a complete and feasible implementation schedule; (b) satisfying OMB that appropriate controls are in place to assure that funds are not diverted to support traditional operations; and (c) reporting to OMB frequently on progress or problems. No funds will be distributed to an agency without meeting these conditions.

Question. Why should "EOP" be charged with \$83.9 million in "BA" if the funds are actually to be spread by budget function?

Answer. This account in the EXOP chapter has traditionally been used to account for management improvement efforts that benefit the government as a whole. The \$83.9 million is being requested to complete President Reagan's Reform '88 management improvement program.

Question. How can you justify this type of expenditure of funds at a time when we are trying to rein in the budget deficit?

Answer. This investment in the most needed Governmentwide management improvement efforts will result in savings valued at many times the initial costs, and, more importantly, lay the foundation for furnishing quality services to the American people in the future.

DRUG PROGRAMS

Question. In the new tables the Committee received yesterday from OMB, you are showing a Bush Priority of \$443 million under a drug initiative within the Department of the Treasury. Is this \$443 million the cost of a new drug initiative under the Bush Administration or, does this amount reflect the amounts requested by President Reagan for the Customs Service plus the additional \$10 million requested by President Bush?

Since we have not received any budget amendments, could you tell me specifically what the \$10 million will be used for? Why does the table show a Bush priority of \$443 million instead of \$10 million?

Answer. The 1990 Drug Program Budget for Customs requests \$442 million in total budget authority (our original estimate reflected a \$1.0 million miscalculation) and \$432 million in total outlays. This program level contains the additional \$10 million, requested by President Bush, with \$7 million allocated to the containerized cargo initiative and \$3 million to Customs' money laundering activities.

The total 1990 Customs' Drug Program provides increases in key areas: 1) 550 FTE and \$28 million to fund significantly increased levels of intensive examinations of cargo containers for illicit drugs; 2) \$5 million for the Treasury Enforcement System II (TECS II) to provide improved intelligence and investigative support to Customs, Treasury, and other law enforcement agencies; and 3) \$3 million to augment money laundering activities so Customs can broaden its efforts to trace the international flow of illegal funds.

Question. Another item which is confusing in the new tables is a proposed drug initiative for IRS in the amount of \$56 million under Bush priorities. Can you explain what this \$56 million will be used for?

Are you increasing IRS' budget to reflect the new authorities for criminal investigations in the 1988 Drug Bill, or are you simply showing an amount that was already reflected in the Reagan Budget?

Answer. The \$56 million for IRS anti-drug activities funds on-going current levels of activity for the IRS, primarily in the Criminal Investigations area.

ANTI-DRUG BUDGET

Question. One of my Senate colleagues recently labeled President Bush's 1990 budget "unorthodox and confusing." As I have attempted to sort out the President's proposed budget figures for anti-drug programs, you can add me to the list of those confused. I have a document here from OMB that shows an increase of nearly \$1 billion in budget outlays from FY 1989 to FY 1990 for anti-drug programs. But, I have another document from CBO that estimates the Bush budget as only a \$344 million increase in budget outlays from FY 1989 to FY 1990. To illustrate the discrepancy between the OMB and the CBO estimates, consider outlay estimates for the Drug Enforcement Administration. OMB estimates \$526 million in outlays for the DEA in FY 90, while CBO estimates the DEA outlays at \$413 million.

It appears to me that the Administration is simply playing the numbers game to come up with \$1 billion in new funding. Can you explain why there is such a wide discrepancy between the OMB and CBO for drug program outlay estimates?

Answer. The CBO estimates for FY 1990 include outlays associated only with new budget authority. OMB estimates include outlays associated with both new budget authority and budget authority from prior years. Therefore, the estimates are not comparable.

Regarding DEA outlays, it is possible that CBO has tabulated only part of the agency's outlays as drug-related. OMB, on the other hand, tabulates all of DEA as drug-related, and we have included that agency, in its entirety, in our drug estimates.

IRS REVENUE INITIATIVES TO FUND DRUG PROGRAMS

Question. I have a question regarding a January 24th letter sent to President Bush by Senator D'Amato and myself. In this letter we offered several suggestions on methods to fund the remainder of the 1988 Anti-Drug Abuse Act. I have not yet received a reply on our suggestions. Let me read one paragraph from the letter that pertains to OMB: In a September 30, 1988 letter to the Senate Budget Committee, the Director of OMB estimated that an additional \$123 million to enable the IRS to hire 2,827 tax enforcement personnel would yield an additional \$206 million. On March 21, 1988, IRS Commissioner Lawrence Gibbs testified before the Treasury Appropriations Subcommittee that IRS estimated that an additional \$286 million dedicated to an IRS revenue-raising initiative

With the budget crisis we are faced with I would think the proposed IRS initiative, even if it only raised an additional \$200 million, would be well worth undertaking.

Why has OMB not given IRS the personnel to go ahead with this effort?

Answer. The President's 1990 budget contains Internal Revenue Service revenue initiatives that yield \$318 million. These revenue initiatives represent IRS's current estimate of the most productive use of additional resources to generate additional revenues.

IMMIGRATION AND NATURALIZATION SERVICE

Question. President Reagan's fiscal year 1990 budget request for INS provided an increase of \$44 million, over the FY 89 level, yet it included deep cuts in the number of U.S. border patrol officers from the information made available thus far on President Bush's revised budget, I believe the INS numbers have not changed from the Reagan budget.

Can you tell me what is in the revised budget for INS?

Answer. The 1990 request totals \$874 million--\$866 million for salaries and expenses and \$8 million in the Organized Crime Drug Enforcement (OCDE) initiative. In addition to OCDE funds, the request covers inflationary increases and two program enhancements--\$9 million for two alien detention facilities and \$1 million for instructors at a new training center in Artesia, New Mexico. The 1990 INS budget represents a \$52 million increase, or six percent over the 1989 enacted level. The INS budget is among the priority programs, in the drugs and crime initiatives in "Building a Better America."

Question. What troubles me is that the 2,000 mile southwest border is the number one transit point for illicit drugs coming into our country, yet the border patrol, the lead agency for drug interdiction between the ports of entry and the agency that seized 60 percent of the marijuana and 40 percent of the cocaine confiscated along the border last year, has its total number of officers working the border slashed by 250.

I would think that if this administration is serious about preventing drugs from entering our country they would be adding border patrol officers and not cutting.

How does OMB justify these recommended cuts?

Answer. Proposed 1990 funds for INS' Border Patrol are \$14 million greater than the 1989 enacted level, a 6 percent increase. Since the Immigration Reform and Control Act (IRCA) of 1986, border enforcement has become more effective.

- Border patrol FTE would be 4,115 in 1990--a 10 percent increase over 1987's 3,731 FTE.
- Border apprehensions of illegal aliens declined 43 percent from 1986 to 1988. This suggests that fewer illegal immigrants are coming over the Border.
- Drug interdictions at the border in 1988 increased 17 percent over 1987 levels.
- Criminal alien apprehension increased 72 percent from 1987 to 1988.

Since implementation of the Employer Sanctions Program in December 1986, illegal alien apprehensions at the border have decreased as sanctions enforcement has escalated from 1987 to 1989. Examples of sanctions enforcement increases are:

- Fine notices served employers of illegal aliens totaled 648 in 1988. During the first three months of 1989, 575 fines were issued.
- Fine amounts totaled \$2.3 million in 1988--\$2.5 million has been assessed during 1989's first three months alone.

STATE AND LOCAL ANTI-DRUG ABUSE GRANTS

Question. President Reagan's final Budget demonstrated the same commitment as his previous budgets to State and Local law enforcement--it cut out all funding for the Drug Grant Program. I commend President Bush's revised budget for restoring \$150 million in funding for the State and Local Grant Program. However, the \$150 million falls far short of the \$350 million authorized in the 1988 Anti-Drug Abuse

Act. I agree with a statement made by William Bennett to the National Governor's Association Monday, that "The Federal Government has a significant role to play in this area".

What role do you see the Federal Government playing when it comes to providing financial assistance for State and local law enforcement in the fight against drugs? Do you believe we can carry out that job with \$150 million?

Answer. The Administration is proposing to strengthen law enforcement efforts at all levels of government -- Federal, State, and local. The request for \$150 million for State and local anti-drug abuse grants is an example of the Administration's commitment. The 1990 proposed funding level is the same level as the 1989 appropriation. However, with new provisions in the Anti-Drug Abuse Act of 1988, the State matching requirement will be increased from 25 percent to 50 percent. Since formula grants represent 80 percent of the amount appropriated, this will result in an additional \$30 million to fight drugs.

FUNDING FOR INDIAN WATER RIGHTS SETTLEMENTS

Question. Mr. Darman, over fifty lawsuits are now pending before state and federal courts to resolve disputes over tribal rights to water flowing on or past Indian reservations. Litigation is costly, time consuming, uncertain in outcome, and once decided, can displace existing water uses and provide only paper rights, not "wet water." The prolonged uncertainty clouds the validity of water rights for Indians and non-Indians alike, forestalling investment based on the availability of, and rights to water, thus hurting tribes, businesses, states and the nation.

As a result of this pending litigation, the previous administration undertook an aggressive program to negotiate settlements for the outstanding Indian water rights claims throughout the West. Secretary Lujan indicates that this policy will continue. Last Congress, three settlements were enacted into law -- the Salt River Pima-Maricopa in Arizona, San Luis Rey in California and Colorado Ute in Colorado. These settlements anticipated federal funding in FY 90 of \$76 million. However, in the FY 90 budget request, there is only \$15 million.

Would you consider it a general philosophy of the Bush Administration to negotiate rather than litigate Indian water rights claims?

Answer. The Bush Administration favors negotiated settlements over litigation to the extent that negotiations result in an outcome better than the likely outcome of litigation for all parties. We do not subscribe to the notion that negotiations are always preferable to litigation, especially when Federal taxpayers are asked to contribute substantially more than they might pay as a result of litigation.

Indiana water rights claim and settlements involve a complicated blend of legislation, treaties, court decisions, history, social policies, technology, and practicality. These interrelated factors make it hard to formulate rules to determine exact settlement contributions by the various parties involved in a specific claim.

For example, the Federal Government has an on-going trust responsibility to Federally recognized Indian tribes that, at times, may exceed the Government's legal liability for a water rights claim. However, it is extremely difficult to quantify this trust responsibility and apply it consistently across all proposed settlements. The Administration therefore believes that, as a general rule, the Federal contribution to a settlement should not exceed its legal liability if the claim were adjudicated.

Question. To what degree does the current Administration consider it an obligation of the United States to resolve outstanding Indian water right claims?

Answer. The Bush Administration recognizes the importance of settling legitimate claims brought by tribes against States, private entities, and the Federal Government. Tribes should not be forced to litigate where the evidence is clear that rights exist. The Federal Government has a trust responsibility to assist tribes in quantifying their water rights. However, where litigation is the only route available to tribes, the Federal Government, as trustee, should ensure that tribes receive the resources necessary to pursue through the courts just and meritorious water claims.

Question. What do you anticipate the effect of under funding these Indian water rights settlements to be on future negotiations?

Answer. We expect to continue to work toward settlements of legitimate Indian water rights claims to which the Federal Government is a party. It is important, however, for negotiators to be realistic in

their expectations, particularly when budgets are highly constrained at the Federal, State, and local levels.

The three recently enacted water settlements (Salt River, AZ; San Luis Rey, CA; and Colorado Ute, CO/NM) commit the Federal Government to provide \$113 million in FY 1990 and \$284 million through FY 1994. For the foreseeable future, such commitments will be difficult to fully fund and will make it even more difficult to finance other meritorious water settlements.

Question. Would you consider it a disincentive for tribes to proceed with negotiating future water rights settlements if they are funded by a reorientation of the Bureau of Indian Affairs budget at the expense of other Indian programs?

Answer. Yes, if that is in fact the case. However, budgeting for Indian water rights settlements should be treated in the same manner as budgeting for other Federal programs. Such settlements should compete with other important funding priorities within the Department of the Interior as well as the Federal Government.

Question. Would you not agree that if these disputes proceed to judgment, funds for the damages found against the United States would come off budget through the Department of Justice Settlement Fund?

Answer. Claims against the Federal Government that proceed to final judgment are usually funded from the Department of Treasury's Claims, Judgments, and Relief Acts Fund. This fund is not "off budget", inasmuch as expenditures from it increase the Federal budget deficit.

Question. What are your thoughts on establishing a separate allocation, off budget, to fund Indian water rights settlements?

Answer. OMB would not be in favor of establishing a fund off budget for settling Indian water rights claims. As important as these settlements are, they must be balanced with the other competing priorities of the Federal Government in the annual budget and appropriations process.

Question. Do you anticipate increasing the budget request for the three settlements enacted into law last Congress?

Answer. The part of the budget that would fund the three water settlements in question is in the residual, non-defense discretionary category. Consequently, the issue of how much FY 1990 funding will be allocated to the settlements will be one of many that the Administration will review and negotiate with Congress as the budget process proceeds.

RILLITO RIVER FLOOD CONTROL PROJECT

Question. Mr. Darman, the Secretary of the Army has approved an Army Corps of Engineers flood control project on the Rillito River in Pima County Arizona. Unfortunately, this project has met with resistance at OMB. I just want to ask that I have the opportunity to sit down with you to explain the unique nature of water management in arid region. I'm sure that upon closer review you will no doubt come to the same conclusions that the Corps has throughout their review process on the Rillito River project and will see the necessity of this project to protect life and property.

Answer. Our meeting on the proposed Army Corps of Engineers Rillito River project was most informative. We will carefully review the additional project background materials, which you asked your staff to send to OMB.

As you know, Executive Order 12322 requires that OMB review all water project feasibility reports prior to transmittal to Congress. This review of the technical and policy aspects of the proposed Rillito River project is in progress. These additional materials will be reviewed and your views fully considered before the Administration adopts a final position on authorization for construction of the proposed Rillito River project.

QUESTIONS SUBMITTED BY SENATOR DALE BUMPERS

SMALL BUSINESS ADMINISTRATION

Question. Mr. Darman, are you aware of the situation facing the Small Business Administration's guaranteed lending program?

As was reported in the Washington Post on February 21, there is now a severe funding shortage in this program which has arisen in the last six months. The Sec. 7(a) guaranteed loan program has been the primary small business loan program since Congress agreed to eliminate most direct loans about four years ago. Banks just will not provide long-term debt financing to small firms without the SBA guaranty. The program has been frozen at about \$2.4 billion for three years, and this has been sufficient to keep the program going. The appropriated figure is about \$400 million below the authorized level.

In the last six months, there has been a dramatic increase in demand by lenders for the SBA guaranty on small business loans. The reasons are not entirely clear, but it seems to be a result of both increased economic activity in certain areas of the country, especially California and Texas, and also to better efforts by SBA to make the public aware of the program. There are now large backlogs in applications for loans in most parts of the country. In California, for example, loan activity for the first two months of 1989 was up 70% over the previous years. SBA is now rationing lending authority to various areas of the country as best they can.

The situation is extremely serious, and members of Congress are receiving a large amount of mail from lenders and borrowers asking for a supplemental appropriations, which I have told the public is extremely unlikely. In my judgment, the program will likely shut down completely at least 60 days before the end of this year, and perhaps at the beginning of the fourth quarter. Both lenders and borrowers who have one or two bad experiences with the program are likely to give up on it.

OMB could help resolve this problem almost immediately by approving a request by SBA to reprogram about \$200 million from other programs which is not being used. This is money already appropriated, and reprogramming is a procedure specified in the Budget Act to accommodate just such a situation as this. All that is needed is OMB's approval of a request by SBA

and the concurrence of the Appropriations Committees. I can almost guarantee that such a request would be favorably received in this Committee.

Are you prepared to make such a request? I understand that earlier this year OMB gave a signal to SBA not to make a reprogramming request, but that SBA now deems the situation so serious that they are once again on OMB's doorstep. What are you prepared to do about this situation?

Answer. Yes, we are aware that the Small Business Administration's Section 7(a) general business guaranteed loan program has experienced increased demand during FY 1989.

OMB has been monitoring developments in this program. We have reviewed and approved SBA's request to reprogram funds from other SBA guarantee programs which are experiencing lower than anticipated demand to the general business guaranteed loan program. Specifically, SBA will reallocate \$85 million in loan guarantee authority from the Development Company program and \$115 million in loan guarantee authority from the Investment Company program to meet demand in the Section 7(a) program. This will bring the total guarantee authority for the general business program to \$2.6 billion for FY 1989.

Approval of the reprogramming involves a reapportionment of funds within the total guarantee levels set in appropriations report language.

QUESTION SUBMITTED BY SENATOR TOM HARKIN

MEDICARE PAYMENT SAFEGUARDS

Question. OMB cut \$231 million from the Health Care Financing Administration's (HCFA) request for "payment safeguard activities," aimed at curtailing fraud and abuse in Medicare. According to the Administration's budget documents, this will result in the loss of nearly \$2 billion to the Federal Treasury.

What is the rationale for cutting back on Medicare audit activities, which have been so successful in saving the taxpayers money?

Wouldn't the Appropriations committee actually be reducing the Federal deficit if we restored your cut in Medicare contractor's payment safeguard activities ?

Answer. The FY 1990 Reagan budget included a 6 percent increase in funding for Medicare contractors. The Bush budget includes contractor funding in the residual freeze pool. It is our expectation that there will be programs in this residual category for which an alternative funding mix will be judged desirable and/or necessary.

Contractor funding constitutes 75 percent of the HCFA program management appropriation; payment safeguard funding totals about 20 percent of the FY 1989 enacted appropriation. Within the program management account total, funds can be reallocated to high priority areas.

In addition, because significant variation in return on payment safeguard investments exists (i.e., between the three types of safeguard activities and among the 88 contractors), the funding level does not exclusively determine benefit savings. Allocating funds to high-return activities and/or to high-return contractors could enhance efficiency and maintain traditional savings levels.

QUESTIONS SUBMITTED BY SENATOR BARBARA A.
MIKULSKI

ASSISTED HOUSING MODERNIZATION

Question. In his Presidential campaign and later in his inaugural address, President Bush spoke of the need to have a kinder, gentler nation. One of the most significant areas where he has talked about this kinder, gentler nation is in dealing with the homeless.

As chair of the Subcommittee on HUD-Independent Agencies, I think that the best way to address the homeless problem in our country is through having a national housing policy. We have not had a housing policy for the last eight years. HUD funds have been cut by over 60 percent and assisted housing has been cut by more than 75 percent.

Central to having a national low- and moderate-income housing policy is through preserving the existing housing stock we have. With that in mind, let me ask you, why is the Administration only requesting \$1 billion for public housing modernization in FY 1990, a cut of \$600 million or over 60 percent over last year, when a private study done for HUD puts the modernization need at \$20 billion and when HUD's own internal estimates say the need is at least \$10 billion?

Answer. While it is true that new budget authority for subsidized housing decreased from \$27.9 billion to \$9.7 billion over the past eight years (1980-1988), this fact does not reflect either the lack of a housing policy for low-income households or an abandonment of the effort to secure decent housing for every American family. Instead, it reflects a growing consensus between the Congress and the Administration that the excessively costly new construction programs of the 60s and 70s were no longer affordable or most effective in meeting the dominant housing problem facing poor families -- housing affordability and excessive rent burdens. Because of the shift toward housing vouchers and tenant-based housing subsidies, HUD's outlays for subsidized housing increased dramatically from \$5.6 billion in 1980 to \$13.9 billion in 1988, and will grow to an estimated \$16.2 billion by 1990. Most importantly, the number of households receiving HUD assistance has increased 1.1 million -- from 3.1 million households in 1980 to 4.2 million in 1988. By 1990, the number of HUD assisted households is estimated to reach 4.4 million.

In the public housing modernization program, new budget authority has increased from \$545 million for capital improvements in 1980 to \$1.6 billion in 1989. Over the past three years (1987-1989), funding for modernization has totalled \$4.8 billion, more than double the amount provided over the prior three-year period (\$2.3 billion, 1984-1986).

Because of this recent doubling of funding for public housing modernization, there is over \$3 billion in the modernization pipeline that remains to be spent to help reduce HUD-estimated backlog needs of \$8-\$10 billion from the Abt study on modernization needs you cited. With the \$1 billion in 1990 modernization proposed by the Administration, these funds will substantially reduce mandatory backlog needs by the end of 1990.

The Administration has also proposed that \$250 million of the requested \$1 billion funding level be set aside for matching State and local grants. This reform will not only provide an additional \$250 million of non-Federal funds to improve these locally-owned public housing projects, but secure State and local active participation in decisions to preserve these units.

OMB BASELINE FOR ASSISTED HOUSING

Question. This year, for the first time in memory, OMB decided not to include any new public housing units in its "current services" baseline. That automatically reduces the starting point from which we calculate the budgetary needs of the Department of Housing and Urban Development.

I don't dispute OMB's right to make a policy baseline which doesn't provide for any new public housing units. But to portray HUD's current services baseline as not including any new public housing units, when in FY 89 we appropriated funds for nearly 7,000 new units, is misleading.

Why did OMB take this step and how does that fit in with the President's theme of a kinder and gentler nation?

Answer. OMB changed the way the assisted housing current services baseline is calculated in order to make it conform more closely with the generally accepted notion of current services, that is, the amount of budget resources necessary to continue serving the same number of households currently receiving housing assistance. This means that "new"

current services BA covers the cost of serving all existing households, including the costs of renewal of all expiring subsidy contracts on an in-kind basis. It does not cover the BA costs for assisting additional families.

Up until this year, current services figures included the costs of serving both the existing number of households and the same level of additional households as added in the prior year. However, this approach prejudices a major policy issue of how many additional families to serve each year.

OMB's position is that the new definition is more appropriate conceptually because it provides a good base for the President and the Congress to consider how many additional households to serve each year.

CBO uses another more straightforward definition for computing its baseline; it is equal to last year's appropriation with an adjustment for inflation. This approach completely ignores whether these funds will be used to renew subsidy contracts (which, in the next few years, will consume much BA) or be used, instead, for serving new households.

COST OF VOUCHERS V. CERTIFICATES

Question. The Administration is again proposing to eliminate the use of housing certificates and fund any new low-income housing assistance with vouchers. The GAO recently submitted a study to me that says vouchers cost at least 7% more than certificates. In fact, for the first year for which figures were available, GAO found that vouchers served 9,500 less families than if the identical amount of money had been given for certificates. What steps do you plan to take to review the cost of certificates v. vouchers and if GAO's estimates are correct, doesn't it make sense to use certificates instead of vouchers?

Answer. While the GAO report concluded that vouchers were more costly than certificates, it also concluded that vouchers offered added benefits. Accordingly, GAO was careful to emphasize "that it does not take a position favoring either vouchers or certificates."

The Administration is not convinced by the cost analysis in the GAO report. The Department of Housing and Urban Department commented that the "GAO report is based on old data collected in the first year of the demonstration study, which does not include any information concerning changes in subsidy costs and

rent burdens experienced in the second year. Many of your conclusions are based on assumptions that are not supported by the facts. It would be a great disservice to provide Congress a report based on supposition, when the Abt report with the current data will be available momentarily." (See page 57 of GAO Report.)

SAVINGS & LOAN CRISIS

Question: Mr. Darman, there is a great deal of concern about the effect of the S&L bailout on the federal budget deficit. If we agree to a freeze on total budget outlays in Fiscal Year 1990 and then have an additional billion or so in interest payments to make because of the S&L bailout, this Committee will have even tougher choices to make than it already has.

Can you tell me what the total federal cost of the bailout will be, over what period of that time the cost will occur, and whether or not the "on-budget" costs of the bailout will be scored to the Appropriations Committee as part of its 302a allocation?

Answer. FY 1990 outlays associated with the financial institutions funding and reform proposal are \$1.9 billion as estimated by the Administration in February. There are three major components to this estimate:

- (1) Net outlays of the FSLIC Resolution Fund (making payments on past commitments) and the Resolution Trust Corporation (handling unresolved cases): \$1.4B;
- (2) Contributions by Treasury for interest on bonds issued by the proposed privately-owned Resolution Funding Corporation, which will raise \$50B over 3 years for case resolution: \$1.4B; and
- (3) Additional FDIC budgetary offsetting collections from a proposed premium increase on FDIC-insured banks to restore that insurance fund to soundness: \$-0.8B.

The accompanying Funding Summary table provided to the Senate Banking Committee in testimony on March 2 provides the federal budget outlay estimates for the Administration's plan and its major components for each year through 1994 and 1989 - 99 totals. We believe these figures best represent the on-budget "costs" of the Administration's savings and loan plan.

The Administration proposes that the appropriation for REFCORP interest will be allocated as a mandatory spending item to the authorizing committees, as the appropriation is to be handled in the initial authorization bill.

We expect that the other appropriations requirements for the FSLIC Resolution fund and (after 1990) for the new savings and loan insurance fund to be mandatory appropriations, scored to the appropriations committees.

Question. Last week, the House Banking Committee released a document that says that issuing bonds to pay for the bailout, as the Administration proposes, will ultimately cost the taxpayers of this country \$138 billion more than by a direct federal appropriation. Can you tell us why it is that your estimates of the cost are so much lower than that of the House Banking Committee? If you can't be more specific today, then I'd like a written analysis for the Committee within five working days.

Answer. Our estimates assume that the spread over comparable Treasury securities of bonds issued by the proposed privately-owned Resolution Funding Corporation (REFCORP) will be 25 basis points. Over the 30-year term of the bonds, therefore, interest costs will be \$3.75B more than for Treasury issues, or about \$1.2B on a present value basis.

- o It appears that House Banking's analysis failed to include Treasury's own interest costs should it issue the bonds directly, rather than REFCORP. (Using our February interest rates, the total interest expense on \$50 billion of 30 year Treasury bonds would be just over \$135 billion.)
- o Our financing mechanism is designed to ensure an industry contribution to the financing of insolvent thrift cases (through FHLB earnings, premiums, receivership proceeds, and returns on warrants) that would be more difficult to obtain if Treasury issued its own bonds.
- o Straight Treasury financing would require an exemption of associated FSLIC outlays from the G-R-H targets, which may unsettle the financial markets should it set a precedent for exempting a host of other Federal programs.

PROPOSED "PIERCE" ACT FUNDING SUMMARY
(in billions of dollars)

	1989	1990	1991	1992	1993	1994	1989- 1994	1989- 1994
PSLORTC Disbursements	27.7	31.2	22.6	7.6	6.3	6.6	103.2	126.2
Old Cases and Other Expenses	17.7	6.2	6.6	6.4	4.7	3.6	43.2	62.2
New Cases	10.0	25.0	17.0	2.4	3.6	2.0	60.0	74.0
Collections (-)	-17.0	-29.8	-16.6	-3.2	-3.6	-3.6	-73.6	-86.3
New FICO (RESPORT) Bonds	-10.0	-25.0	-16.0	--	--	--	-50.0	-60.0
Old Premiums (Net)	-1.4	0.4	0.3	-1.6	-1.6	-2.0	-6.6	-19.0
Additional Premiums ¹	--	--	-0.3	-0.3	-0.3	0.4	-0.4	2.1
Other Old Collections	-6.6	-6.2	-1.6	-1.4	-1.6	-1.9	-17.5	-21.4
PSLORTC Net Outlays	10.7	1.4	6.0	4.6	4.7	2.3	29.7	37.9
Treasury Payments for Bond (RESPORT) Interest	0.6	1.4	1.6	0.9	0.6	1.1	6.3	22.0
Additional FISC Collections	0.0	-0.8	-1.6	-1.7	-1.8	-1.9	-7.9	-19.9
TOTAL BUDGET OUTLAYS	11.1	1.9	6.0	3.8	3.7	1.6	28.1	39.9

¹ A (-) indicates increase in premiums, a (+) indicates a decrease.

QUESTIONS SUBMITTED BY SENATOR MARK O. HATFIELD

FOREST FIRE FIGHTING FUND

Question. The FY 1990 budget request contains a provision to establish a new mechanism to fund forest fire fighting activities on federal land. As I understand it, the Federal government would create a new forest fire fighting fund by deducting a percentage of shared resource and mineral receipts prior to distribution to state and local governments. This procedure would replace the current mechanism which we have used in the past whereby partial funding was provided annually by the Interior Appropriations bill, and a supplemental request was made later, following the fire season, to pay for any unfunded expenses.

Under the terms of this new proposal, the state of Oregon, which is forecast to receive approximately \$234 million in shared timber and mineral receipts in FY 1990, would have to pay about \$43 million in fire fighting costs next fiscal year. This is a significantly greater amount than any other state in the union would be required to contribute.

Why should Oregon be required to contribute more resources than other states when, for example, last summer's worst forest fire was in Wyoming?

Answer. In developing its proposal for funding forest fire-fighting costs, the Administration considered an option whereby fire costs in a given State would be deducted only from the receipts generated from Federal lands in that State, prior to receipt-sharing with that State. However, this approach was rejected because, due to the variability of where fires occur and how severe they are, this approach could subject States to large swings in receipt-sharing revenue from one year to the next.

We believe the underlying fairness of the Administration proposal is best explained by drawing an analogy with an insurance policy. Taken as a whole, Federal lands generate revenues for many beneficiaries. To preserve the stream of revenues, the Federal Government engages in a fire protection program, at a total cost much less than total revenues. However, for a single State in a given year, Federal fire-fighting costs may actually exceed gross Federal receipts. Like an insurance policy, pooling revenues that are generated by Federal lands across all States, and deducting fire costs from this pool prior to distributing revenues to beneficiaries, would spread

costs evenly and thereby eliminate catastrophic risk to any single beneficiary. The relatively small reduction in each beneficiary's revenue would constitute, in effect, an insurance premium.

Such a premium would be both practical (since it would eliminate catastrophic risk) and equitable. The reduction applied to each beneficiary's payment would be the same, in percentage terms, as that applied to every others. The reduction would be greatest for States that receive the largest amount of Federal receipts, and proportionately less for States that receive smaller amounts.

FOREST FIRE FIGHTING FUND

Question. Is not this proposal just another attempt by the Administration to raid the shared receipts accounts, and reduce payments to State and local governments?

Answer. Having characterized the deduction for fire costs as an insurance premium, it is important to emphasize that the Federal lands -- not States -- would actually pay this premium. The fundamental premise of the Administration's fire-fighting initiative is that the Federal lands should finance their own fire protection. We do not propose to send each State a bill for Federal fire-fighting costs, to be paid from State-generated revenues. Rather, we propose to deduct fire costs from receipts generated by Federal resources, that are owned by all American citizens.

If this approach is unacceptable, the Administration is willing to work with Congress to develop some other means of fully funding fire-fighting costs that is equitable and does not increase the Federal budget deficit.

MITCHELL ACT HATCHERIES

Question. The FY 1990 budget requests no funding for the operation and maintenance of the Mitchell Act fish hatcheries on the Columbia River. In light of the fact that those hatcheries are the result of a Federal commitment to mitigate the impact of the construction of Federal dams on the Columbia river, and to fulfill treaty obligations to Indian tribes and Canada, why does the Administration continue to delete these funds?

Answer. Under the Mitchell Act, hatcheries were constructed to mitigate the impact of Bonneville Power Administration (BPA) dams on the Columbia River. The hatcheries were not built to meet treaty obligations.

The BPA dams were constructed specifically for the benefit of the residents of the Pacific Northwest. Therefore, the Administration proposes that the costs of mitigating the effects of the dams be covered by the beneficiaries rather than the general taxpayer. Under the Administration proposal, the hatcheries would be funded through a surcharge imposed by BPA on its customers.

NEED FOR ADDITIONAL DATA

Question. Your statement goes to some length to describe all the budget information transmitted to date by this Administration. The provision of this information is in keeping with the President's expressed intention of full cooperation with the Congress, a stance that is greatly appreciated in this Committee and elsewhere.

As Chairman Byrd has pointed out, however, this Committee has a particular requirement for formal budget amendments at the account level, and program detail.

When will we receive budget amendments for your proposals?

For the accounts to which you propose no budget amendment, are we to assume that President Bush endorses the budget request of President Reagan?

Specifically for defense, when can we expect the programmatic detail supporting the request for each account?

Answer. The formal request for appropriations needed to implement most of the initiatives that were identified in Building a Better America, the February 9 budget transmittal, were transmitted to the Congress on March 10. The others, including defense and land acquisition, will be transmitted soon.

In a February 16, 1989 memorandum for heads of departments and agencies, the Director stated that for purposes of starting the budget process with the Congress, the Reagan budget proposals for those items that are not Bush initiatives identified in the February 9 budget should be treated as if they were Bush Administration proposals. Therefore, for those accounts where no budget amendments are being proposed, you should assume that President Bush endorses the budget request of President Reagan, at least as a starting point for negotiation.

Specific adjustments to the Defense program included in the January budget have not yet been determined either by account or by program. The President said in his February 9 budget request that, within 60 days, the Secretary of Defense will provide to the President specific program recommendations to meet 1990-91 budget targets without impairing national security. The Secretary will also report to the President recommendations to improve defense management. In addition, the President has instructed the National Security Council to review our national security policies and defense strategies with a view to ensuring compatibility among our commitments, strategies, capabilities, and resources.

NATURALLY DECLINING PROGRAMS

Question. Appendix D of your prepared statement lists a number of programs described as mandatory that are purported to "naturally decline" under current law.

I am puzzled by how you may have arrived at this calculation. Can you provide us with a few examples here, and for all the programs listed for the record, of the circumstances prompting this "natural decline?"

Second, it appears that the calculation of savings from this natural event is measured from the "wonderland budget" of a current services baseline. Is that correct, and if so, would you provide a similar display of these programs based on the common sense budget of current enacted levels?

Answer. In response to the first part of the question, certain mandatory programs decline from 1989 to 1990 because of factors generally peculiar to each program. (In other years, of course, such programs can -- and often do -- naturally increase.) Such year-to-year changes are the result not of changes in legal eligibility requirements but the result of changes in the factors that determine whether a person or organization meets the requirements. They can decline (or increase) naturally because of estimates regarding caseloads, average benefit payments, crop conditions, the number of failed banks, cost of living adjustments, interest rates, and many other factors. Some of the programmatic assumptions that underlie these changes can be found in the Special Analysis volume of the 1990 Budget, page A-10. Moreover, for accounts that include offsetting collections, changes from year to year can also result from changes in these collections, which are often user fees.

Appendix D identifies a list of programs that are estimated to decline naturally from \$51.9 billion in 1989 to \$41.9 billion in 1990, a total estimated decline of \$10.0 billion. More than half of the decline, or \$5.1 billion, is for the Federal Deposit Insurance Corporation, because the number of failed banks requiring assistance is expected to decline. The remaining items on the list are all estimated to decline from 1989 to 1990 by less than a billion dollars each. The largest are:

- the Federal Housing Administration (excluding asset sales), which is estimated to decline \$951 million primarily due to increased receipts from projected single family property sales and an expected decrease in the amount of claims;
- the Commodity Credit Corporation and the crop insurance fund, which together decline an estimated \$1.1 billion. The CCC outlays decline in part because disaster payments that occurred in 1989 due to the drought are not expected for 1990. The crop insurance fund outlays decline because losses in 1989 were higher than those expected in 1990, also due to the drought.
- supplemental security income, which declines an estimated \$351 million because of a technicality in the timing of benefit payments -- there are 12 monthly payments in 1989 and only 11 in 1990. The decrease caused by this technicality is partially offset by higher estimated caseloads and average benefits in 1990 than in 1989.

In response to the second part of the question, the data displayed in Appendix D are current services (i.e., current law) estimates for both 1989 and 1990. This tables does not display any proposed savings from current services -- it displays only decreases from 1989 to 1990 assuming no changes to current law.

The Bush Budget, however, does propose changes to current law for two of these programs. These proposals are included in Appendix E to the testimony. They are for:

- farm support payments with proposed outlay savings in 1990 of \$1.9 billion below current services levels; and

-- guaranteed student loans, with proposed outlay savings in 1990 of \$118 million below current services levels (included in the "Other" category in Appendix E).

For the remaining programs in Appendix D, the Bush Budget proposes no changes to current law.

FROM WONDERLAND BUDGETING TO COMMON SENSE BUDGETING

Question. Mr. Darman, you have described the preparation of budgets predicated on a "current services" baseline as an exercise in "Wonderland Budgeting." In that wonderland, an increase in a program over current year levels may be characterized as a reduction, if the increase is insufficient to fully cover the costs of inflation.

I agree with you that our starting point for analyzing federal expenditures for the upcoming year ought to be the amount enacted for the current year, and not a theoretical projection of spending levels that might occur if a number of widely disputed variables all pan out precisely. As you put it in your prepared statement, "if the real world deficit is to be reduced, programs must not be assumed to be immortal. Inflation must not be built in as a given."

But I would be more agreeable to your proposal if it were more evenly applied. Your budget proposes a substantial increase in budget authority for defense spending, yet you characterize this as a "freeze at zero real growth" -- i.e., maintain current services in terms of budget authority. Yet you propose to freeze FY90 spending for most non-defense discretionary programs at the FY89 level of actual outlays, requiring a reduction in FY90 budget authority below actual levels for FY89.

Can you explain this inconsistency, given your criticisms of "wonderland budgeting?" To be fair and practice "common sense budgeting," shouldn't we also begin our budget deliberations by holding defense outlays in FY90 to no more than the FY89 levels? Wouldn't that make a substantial contribution to deficit reduction?

Answer. The 1990 Bush budget request proposes increases of \$1.4 billion in defense outlays and \$9.1 billion in budget authority above the 1989 level. These increases provide for zero real growth in 1990 budget authority, following a real decline in the defense budget in each of the past four years. The President would have liked to embrace, even for the

short term, the defense budget projections which are in the Reagan budget. The current economic situation, however, requires defense budget savings. These savings, from the proposed Reagan levels, add up to \$44.8 billion in budget authority and \$30 billion in outlays through 1993. Any further reductions would increase the risk of not meeting basic national security objectives.

COMMUNITY SERVICES BLOCK GRANT

Question. President Bush's budget proposed to fully fund the programs under the Stewart B. McKinney Homeless Assistance Act. One of the components of the McKinney Act is an authorization of \$42 million for assistance to the homeless under the Community Services Block Grant. However, there did not appear to be any mention of funding for the basic block grant. Does President Bush intend to eliminate funding for the CSBG program?

How does the elimination of this program critical to the provision of services to the impoverished serve to make us a "kinder and gentler" nation?

If the basic block grant is eliminated (\$318 million in FY'89), how can the community action agencies be expected to survive and carry out the activities under the McKinney Act on \$42 million?

Answer. In the Bush Budget, CSBG could be funded out of the "residual" category. Recognizing the importance of the homeless initiatives authorized by the Stewart B. McKinney Homeless Assistance Act, the Administration is submitting a budget amendment to fully fund the Emergency Community Services Homeless Grant Program (or EHP). Since the EHP authorization is separate from the CSBG Act, full funding for EHP is separable from CSBG funding.

Even if budget negotiations resulted in reduced CSBG funding, the effect on community action agencies (CAA's) should be modest. CAA's now receive less than 15% of their resources from the CSBG. It has been estimated that as much as 40 percent of CSBG funds are used to administer other programs such as Head Start, Low Income Home Energy Assistance, etc. Those programs include funds for administration. Since the CSBG has the same purposes as the \$2.7 billion Social Services Block Grant (SSBG), States could use SSBG funds to finance most, if not all, of the types of services funded by the CSBG.

The Bush Budget does not propose specific budget authority or outlay amounts for spending which falls into the "residual" category of non-defense (mostly) discretionary spending. Rather, the Bush Budget proposes spending \$136 billion on all programs in this category, with the details of that spending to be negotiated with the Congress.

QUESTIONS SUBMITTED BY SENATOR JAMES A. McCLURE

ADOPTION OF FY 1989 ALLOCATIONS
FOR FY 1990

Question. Your efforts during the initial weeks of the Bush Administration to initiate budget negotiations have been plagued with criticism. Nearly every member here would probably put deficit reduction as a top priority for our economy. Yet few have welcomed what I feel are sincere efforts to negotiate a spending plan for the future.

Instead, your motives are being questioned more than your proposal. In reality, however, your proposal is simple: let's sit down and negotiate a spending plan, without taxes, that reaches the Gramm-Rudman-Hollings targets.

The focus is not on when and how to start negotiating. The focus is on the reelection bell everybody is hearing. Everybody is more than willing to roll up their sleeves and start working on their reelection but few seem to be willing to roll up their sleeves and start working of reducing the deficit.

I want to take a moment to commend you for your effort and your patience. If you think everybody is ganging up on you, you're right.

In your opening statement before the Senate Budget Committee, you were critical of what is commonly known as "current services" approach to budgeting. You clearly stated that next year's budget must be framed in relation to last year's actual spending and in relation to available resources and deficit target. It should not be in relation to a "current services" baseline.

It is very important that we focus on the fundamentals that drive ever-increasing spending by the Federal Government. I agree very strongly with President Bush and with you, Mr. Darman, that "Current Services" budgeting is one of the very large factors. When increased spending is viewed as a cut, there does, indeed, exist a problem. "Current Services" analysis can make an important contribution to understanding choices and priorities, but also, distorts, public understanding of spending priorities. Congress must set spending priorities. Congress must accept responsibility for all spending, not just new programs.

I don't want to be critical of my friends on the Budget Committee but for the next few months the Budget Committee will work on a resolution that will recommend an allocation of funds to this Committee. This Committee will essentially ignore those recommendations and divide up the total between the thirteen subcommittees as we see fit. Any negotiations which the Administration may organize will probably be framed in the total amount we are trying to allocate.

Fiscal year 1989 was the first year in a long time in which all thirteen appropriations bills were sent to the President separately and completed on time. The factor which contributed the most to that effort was the budget agreement which gave this committee a total allocation to divide up early in the year.

Why not simply allocate to all thirteen subcommittees the exact amount for budget authority and outlays that were allocated to each subcommittee in FY89?

With the FY90 allocations done and spending frozen, we could move on to the next step in the negotiation process to control the deficit. In addition, everybody would have more free time to work on their reelections.

Let all of us in the Congress accept the President's offer to negotiate. Let's do it now. Let's stop the political shadow-boxing and engage in the compromising that will have to be done sometime. If we don't do it now, there is every likelihood that the Federal Reserve will raise interest rates which we haggle. The country will be the loser and a "politics-as-usual" Congress should bear the blame.

How would adoption of the FY89 allocations fit into the Administration's "flexible freeze" proposal?

Would those totals give you adequate flexibility to work with the Congress to discuss specific programs?

Do you think that negotiating for the next five or six months would give the Administration a better deal?

With your current revenue assumptions, would there be a sequestration if the FY89 enacted totals were also the FY90 totals?

Answer. Deficit reduction is a top priority for our economy and we must join together--and do so quickly--to negotiate a workable spending plan for the future.

In theory, adoption of the FY 1989 allocations for FY 1990 would not be inconsistent with application of the residual freeze to those programs it would be intended to cover, i.e., those programs not identified as priorities of the Bush Administration. In practice, it is questionable whether such an approach would allow the flexibility necessary to address the priorities contained in the Bush budget as well as the various program-by-program adjustments--up or down--implicit in the application of the freeze to the residual category.

Whatever approach the Congress ultimately adopts in developing the budget resolution allocations, the Administration will continue to support the priorities identified in the Bush budget within a cooperative spirit of negotiation toward achieving necessary deficit reduction.

With regard to whether or not a sequester would be triggered if the FY 1989 enacted totals were assumed for FY 1990, one must consider the full range of budgetary resources. Sequestration is triggered by the level of total outlays compared with revenues, not just the discretionary portion controlled through the appropriations process. If no other policy changes were enacted other than a freeze of discretionary budgetary resources, in all likelihood sequestration would be triggered.

FOREST FIRE FIGHTING FUND

Question. There is a proposal in the FY90 Reagan budget to restructure the method of funding the costs of fighting fires on Federal lands. Under the proposal, a permanent, indefinite appropriation would be established to provide a source of funds for the fire programs of the various land agencies.

Unfortunately, the proposal did not stop there but proposed that an amount equal to the total estimated Federal cost of fighting fires would be deducted from Federal timber and mineral receipts before the receipts are deposited in the Treasury or shared with states.

Apparently, your predecessor thought that the State and counties started the fires and should pay.

What is the status of this proposal in the new Administration's budget?

Answer. The Bush Administration supports the proposal for funding forest fire-fighting costs contained in the January Budget. We believe the

proposal's combination of permanent indefinite appropriations to fully finance fire costs, and offsetting deductions from Federal mineral and timber receipts, would substantially improve -- without increasing the Federal deficit -- the current piecemeal, extremely cumbersome approach to funding fire costs.

If this approach is unacceptable, the Administration is willing to work with Congress to develop some other means of fully funding fire-fighting costs that is equitable and that does not increase the Federal budget deficit.

Question. Would you be opposed to simply making this a permanent, indefinite appropriation from timber and mineral receipts after States and counties are paid their mandated share?

Answer. Yes, for three reasons. First, paying States and counties their share of Federal receipts before deducting fire costs contradicts the basic premise of the Administration proposal, viz., that Federal lands should pay for their own fire protection and that the deduction of fire costs from Federal timber and mineral revenues constitutes an "insurance premium" that should be shared equally by all revenue recipients.

Second, the proposed deduction from receipts will give States and localities a direct stake in how Federal agencies operate their fire programs. The Administration believes this will encourage involvement by States and localities in the planning and execution of the Federal fire-fighting program, that will ultimately increase the program's effectiveness and efficiency.

Third, from a pragmatic standpoint, a permanent appropriation must be coupled with the proposed deduction from receipts to prevent a substantial increase in the estimated Federal budget deficit. This is not because a permanent appropriation will significantly increase actual fire costs, but rather because it will replace an existing funding mechanism that understates likely fire-fighting outlays.

Question. The current working arrangement used to fund forest firefighting costs stated in section 102 of the Interior Appropriations bill that the Secretary is allowed to use any funds available for the suppression of fires. All funds used under this provision were to be replenished by a supplemental appropriation which must be requested as promptly as possible.

For the first time in several years, the FY 1990 budget requested \$250 million to replenish funds used by the Forest Service during the fires of 1987, 1988, 1989. Unfortunately, the budget did not request funds to replenish accounts used by the Department of the Interior for fire suppression.

I am not pushing this procedure or any other procedure in particular. I simply want to work with you to find a funding solution.

I do feel, however, that this procedure is preferable to taking the funds from the states and counties. It may not, however, be as preferable as to a straight permanent, indefinite appropriation.

How do you plan to proceed with the future funding of forest fires? The status quo where supplementals generally aren't requested? A permanent indefinite?

Answer. The Administration will submit draft legislation to Congress shortly to implement the January Budget proposal for paying fire-fighting costs. We urge Congress to act favorably on it, in a timeframe that will permit implementation in FY 1990.

In the interim, we will continue to rely on existing emergency transfer authorities to finance fire costs. Decisions regarding whether to request reimbursements of transferred funds, via annual appropriations or supplemental appropriations, will be made on an ongoing, case-by-case basis. The need to find programmatically sound offsets for such reimbursements is a serious constraint.

LAND ACQUISITION

Question. The Bush Administration's budget apparently will include \$206 million for land acquisition in FY90 which is roughly the FY 1989 enacted level. How will the \$206 million for FY 1990 be allocated between the agencies?

Answer. A consolidated land acquisition priority list is under development by the Agriculture and Interior Departments. Until the list is finalized, it is not possible to determine the specific allocation of funds by agency and bureau. However, we expect the list to be completed and the allocation determined within approximately 30-45 days.

Question. Generally, what instructions were given to the agencies for the specific land acquisitions? Request funds for their top priorities? Spread the funds geographically?

Answer. The agencies were asked to develop a priority list reflecting the principles enunciated by the President in Building a Better America. These principles emphasize acquisitions that, for example, preserve valuable natural and cultural resources, expand areas experiencing the sharpest growth in recreation use, or serve urban populations. The agencies have also been asked to give weight to factors such as wetlands protection and endangered species habitat preservation. They have not been directed to spread funds geographically.

FY 89 LAND ACQUISITION/FIRE FUNDING

Question. In an effort to build up a separate pot of funds for future fires, a proposed reprogramming was contemplated in the previous Administration to shift \$55 million from land acquisition funds into the firefighting account. I believe "reprogramming" was our phrase. The phrase downtown was "transfer".

What is the status of this proposal?

Answer. The previous Administration's proposal to reprogram \$55 million from land acquisition into the fire-fighting account is no longer under consideration.

Question. What other alternatives are being explored? What alternatives have been rejected?

Answer. We are currently reviewing alternative means of ensuring that adequate funds are available to fight forest fires in 1989.

OUTER CONTINENTAL SHELF

Question. The Administration has proposed to postpone three Outer Continental lease sales which were scheduled for FY90. This additional time will be used by a joint Interior, DOE, National Academy of Sciences task force. This task force is supposed to review and resolve environmental concerns in the three areas.

Since draft Environmental Impact Statements, public hearings, final environmental impact statements, and comments from Governors are already scheduled, what additional information will the interagency environmental task force on Outer Continental Shelf (OCS) leasing be analyzing?

Answer. The President is committed to environmentally sound oil and gas development of offshore areas to ensure a reliable supply of energy in the interests of economic and national security. The interagency task force, comprised of representatives from the Departments of the Interior, Energy and Commerce, the Environmental Protection Agency, and OMB (and with the help of the National Academy of Sciences), will review available information and conduct analyses to assess the concerns of interested parties regarding four specific OCS lease sale areas. The objectives of the task force are to consider, and hopefully resolve, the concerns of all parties.

Question. Does this additional layer of environmental analysis indicate that there are problems with the OCS statute or Department of Interior regulations?

Answer. The OCS leasing process and the associated environmental review process are thorough in ensuring that the interests and concerns of affected parties are included in the decision-making process. Nonetheless, differences of opinion and technical disagreements occur. The task force, in its review of the OCS statute and Department of the Interior OCS regulations, will highlight any problems, should such exist, to ensure that the problems are resolved in an environmentally sound manner.

Question. If so, do you plan on proposing changes?

Answer. Should its review indicate a need to propose changes, the task force will make the appropriate recommendations in its report to the President.

GENERAL PRIORITIES

Question. Your predecessor had a very curious policy which did not allow the Department of Interior to request funds for a particular project in a fiscal year which was added by Congress the previous fiscal year. For some reason, they thought this was a good way to control the deficit.

Even if it was a good idea, it couldn't be requested because the idea came from Congress.

I would hope that your budgets would request funds as a matter of priority and not because the idea came from Congress.

What do you plan to be your general budget formulation instructions to the Departments?

Answer. The Bush Administration wants to negotiate an agreement with Congress on a budget that reduces the deficit, meets pressing needs, avoids new taxes, and provides for investment in the future.

During the budget formulation process there is no presumption that ideas generated by Congress should receive anything less than full consideration. However, in today's deficit reduction environment it is very difficult to add funding for new projects without seeking an offset elsewhere. It is also important to direct limited funding toward projects that meet contemporary economic and environmental standards.

Within the policy and funding constraints just described, funding decisions are made taking into consideration both Administration priorities and the views of Congress.

REPORT LANGUAGE

Question. Mr. Darman, in March of last year, your predecessor Jim Miller advised all federal departments and agencies that they should not consider themselves bound by report language accompanying fiscal 1988 appropriations bills. As I'm sure you are aware, the Congress uses report language to spell out its intent in greater length and detail than in legislative, or bill language. Mr. Miller's unfortunate announcement had the effect of overturning a 40 year old, gentleman's agreement between the legislative and executive branches, and was a source of considerable heartburn for myself and other members of this committee.

In July, 1988, Mr. Miller backed off, at least as regards FY88 funding, as what he described as "a matter of comity between the two branches." However, as a result of the uncertainty created by this policy, a number of important government initiatives in all parts of the country were delayed or disrupted. In the case of two projects involving the Army Corps of Engineers, it took me until this month to get the Corps to fully comply with the intent of Congress, as passed by the Congress well over a year ago.

Even more important, in backing down on the fiscal 1988 funding issue, Director Miller left the door open for future assaults on the time-honored practice of using report language to spell out the will of Congress. I think I speak for my colleagues on the

Committee when I say that we believe that the gentleman's agreement that has operated for over four decades has served us well, and that we should not welcome any further attempts to overturn this arrangement. Let me ask you:

Do you intend to re-open this issue?

What is your understanding of the legal relationship between legislative, or bill language, and report language?

Answer. Under the Constitution, there can be no question that enacted bill language is "law" while report language is not. Report language is neither presented to the President for approval or disapproval, nor voted on and passed by both Houses of Congress. The President and Congress may not, of course, bind themselves to procedures that circumvent the constitutional requirements of bicameral consideration of legislation followed by presentment to the President for signature.

Having said that, we recognize that report language becomes part of a bill's legislative history when the bill is enacted into law. As such, it can provide useful guidance as to the will of Congress.

We believe that Members of Congress as well as Cabinet officers are entirely familiar with these constitutional and interpretative principles, and that it should not be necessary to make an issue of these well established points.

DOE NUCLEAR WEAPONS PLANT MODERNIZATION

Question. In December, the President issued a report to Congress on the Department of Energy's nuclear weapons complex modernization plan. This plan was developed with the full support of the National Security Council and the Department of Defense as well as the Department of Energy. The modernization study recommended new facilities to produce nuclear materials, the consolidation of some activities that use nuclear materials, the closeout of unnecessary facilities, and the restoration and remediation of a number of contaminated DOE sites in the complex.

Are you familiar with this study?

Answer. Yes. The Administration is firmly committed to modernizing the nuclear weapons production complex and to cleaning up environmental damage from past operation. Our budget request includes an

initiative to fund modernization and cleanup activities at the level requested by DOE. President Bush, however, has asked Energy Secretary Watkins to review the detailed recommendations of the modernization study before endorsing all its findings.

Question. With respect to remediation, I think it is clear that cleanup of forty years worth of substandard practices can't be done overnight and some sites are in more immediate need of cleanup than others because of risks to the environment or to public health.

Do you believe these tasks can be prioritized without jeopardizing the national security missions of the Department and the public health?

Will prioritizing tasks facilitate funding for these activities?

Answer. The cleanup cannot be done overnight. The first step, which is going on now, is to examine the sites and get a clearer picture of what needs to be done. When this task is finished, the Department of Energy can place a priority on cleaning each site based on the level of threat it poses to the environment safety or health. The Department can then also make a better estimate of site-by-site costs.

Assigning priorities and realistic cost estimates will greatly facilitate funding. Each year, as the cleanup proceeds, the Administration, together with the Congress, will determine how much funding to devote to cleaning up the highest priority sites remaining. Ideally that decision will be made by balancing the costs and risks of different funding levels against other budgetary demands throughout the government. There is no reason to tie the funding for DOE's environmental cleanup activities to the Department's national security missions.

Question. Are you aware that the modernization study included as a number one priority DOE's recommendations for two new production reactors using two different technologies at two separate sites?

Answer. Yes.

Question. Do you believe this will satisfy the national security need for redundancy, diversity and site duality for tritium production?

Answer. There is a national security need for an assured supply of tritium. The Department of Energy

(DOE) has chosen to meet that need with a dual reactor strategy, using different technologies at two sites. The Department of Defense (DOD) position is that DOE is responsible for an assured supply of nuclear material. Unless DOE is able to show that an assured supply can be obtained by other means, DOD accepts the necessity of duality as advanced by DOE. OMB is in agreement with DOD's position.

DOE SPECIAL ISOTOPE SEPARATION (SIS) PROJECT

Question. The modernization study also included as a top priority, the construction of the Special Isotope Separation project. We find ourselves in the position of having no reactor capacity on line to produce any special materials, which points to the need for the SIS. The SIS will enable us to produce weapons grade plutonium without relying on the Savannah River reactor facilities whose future mission in any event are not likely to include plutonium production.

Besides its primary mission of producing the equivalent of 15 reactor years worth of weapons grade plutonium, are you aware of the other unique capabilities of the SIS including the capability of producing tailored mixtures of special isotopes for a wide variety of military application?

Answer. Yes. However, the justification for building the facility is to provide extra weapon-grade plutonium as a contingency, should demand for the material increase after 1995. According to DOE there are potential uses for very high purity plutonium or for by-product material from production of weapons-grade plutonium in an SIS plant, but the Department has no current or anticipated missions for these capabilities.

QUESTIONS SUBMITTED BY SENATOR ALFONSE D'AMATO

ANTI-DRUG BUDGET

Question. Using the attached "Federal Drug Control Resources Summary" as a model, please provide this committee with a detailed breakdown, by agency and account, of the President's request of \$6 billion to fight drugs.

Please indicate how President Bush's budget request for each anti-drug agency and account compares to the amount appropriated for that agency and account in FY 1989.

Answer. A summary of the \$6 billion FY 1990 request and the amount appropriated for those same categories of accounts for FY 1989 follows:

FEDERAL DRUG CONTROL RESOURCES SUMMARY
By Agency
(Budget Authority in Millions)

							1987	1988
							President's 1988 Budget	President's 1988 Budget
	1981	1982	1983	1984	1985	1986		
DRUG LAW ENFORCEMENT								
Department of Justice								
DEA	219.4	242.7	283.0	327.8	352.5	387.7	490.2	522.0
FBI	8.3	40.1	108.6	99.0	103.3	99.0	108.5	123.9
Criminal Division	1.6	1.9	1.8	1.9	2.7	2.7	2.9	3.3
Tax Division	0.0	0.0	0.8	0.8	1.6	1.8	2.1	2.2
U.S. Attorneys	19.5	20.9	32.7	47.7	54.8	59.9	75.2	102.5
U.S. Marshals	26.3	29.4	31.1	36.0	48.1	52.2	61.8	84.3
Prisons 1/	77.4	97.1	112.3	118.9	176.6	176.3	289.3	323.7
Support of Prisoners 2/	7.5	9.9	18.6	17.2	19.3	19.0	23.2	25.6
Pres. Com. on Org. Crime	0.0	0.0	0.7	1.8	2.5	1.2	0.0	0.0
INS	0.3	0.3	0.4	0.5	0.5	1.0	1.3	1.3
Office of Just. Prog.	4.5	4.4	8.8	7.4	12.9	13.7	240.6	4.7
INTERPOL	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2
	364.9	446.7	598.8	659.1	775.2	814.7	1295.3	1193.8
Department of the Treasury								
Customs	181.1	185.5	186.6	277.7	350.3	380.1	499.8	424.6
IRS	35.2	44.2	50.3	57.4	61.6	63.5	64.0	72.3
BATF	0.0	1.5	4.6	8.3	9.5	7.5	8.2	8.3
Payments to Puerto Rico	0.0	0.0	0.0	0.0	0.0	0.0	7.8	0.0
	216.3	231.2	241.5	343.4	421.4	451.1	579.9	505.3
Department of Transportation								
Coast Guard	227.8	329.2	360.1	508.6	508.2	401.4	552.1	559.9
FAA	0.4	0.2	0.5	0.5	0.5	0.6	1.0	0.7
	228.2	329.5	360.5	509.1	508.6	402.0	553.1	560.5
Department of State								
INM 2/	34.7	36.7	34.7	41.2	50.2	55.1	118.4	98.8
AID (Direct)	0.0	15.7	9.2	10.6	6.7	23.5	6.5	6.9
USIA	1.0	1.0	1.0	1.0	1.0	1.0	2.0	1.0
	35.7	53.4	46.9	52.8	57.9	79.6	126.9	106.7
Department of Agriculture 3/								
Agriculture Research Service	1.4	1.4	1.4	1.4	1.4	1.3	1.4	1.4
U.S. Forest Service	0.5	0.7	0.8	2.6	3.0	3.1	4.1	5.7
	1.9	2.1	2.2	4.0	4.4	4.4	5.5	7.1
Department of Interior								
Bureau of Land Management	0.0	0.0	0.2	0.2	0.2	1.0	1.0	1.0
U. S. Park Service	0.9	0.2	0.5	0.7	0.8	0.2	1.2	1.2
Bureau of Indian Affairs	9.2	9.8	10.8	10.5	13.3	14.6	19.3	14.7
Fish and Wildlife Service	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
	11.1	10.9	12.4	12.4	15.3	16.8	22.5	17.9

	1987						1988	
							President's	President's
							1988	1988
	1981	1982	1983	1984	1985	1986	Budget	Budget
Food and Drug Administration	1.4	0.8	0.7	0.7	0.7	1.6	1.6	1.7
Department of Defense 4/								
Direct operating costs	0.0	4.9	9.7	14.6	34.8	69.7	72.5	75.2
Other appropriations	0.0	0.0	0.0	0.0	0.0	38.0	314.0	0.0
	0.0	4.9	9.7	14.6	34.8	107.7	386.5	75.2
Subtotal, Drug Law Enforcement	859.3	1079.4	1272.8	1596.0	1838.4	1877.8	2971.3	2468.1
DRUG ABUSE PREVENTION								
Department of HHS 5/								
Alcohol, Drug Abuse &								
Mental Health Administration	104.1	57.7	64.4	76.0	86.4	88.0	209.0	137.0
Department of Defense	21.2	36.2	46.4	49.8	63.0	63.4	70.0	72.1
Department of Education	2.8	2.8	2.8	2.8	3.0	3.0	200.0	100.0
Department of Labor	3.4	1.4	0.6	0.4	0.4	0.1	3.0	0.0
Department of Interior (BIA)	0.0	0.0	0.0	0.0	0.0	0.0	5.4	2.3
ACTION	2.5	6.8	6.9	6.8	6.9	10.0	13.0	10.0
White House Conference	0.0	0.0	0.0	0.0	0.0	0.0	5.0	0.0
Subtotal, Drug Abuse Prev.	133.9	104.9	121.1	135.8	159.7	166.5	505.4	321.4
DRUG ABUSE TREATMENT								
Department of HHS 5/								
Alcohol, Drug Abuse &								
Mental Health Administration	154.7	107.0	117.0	116.0	123.0	117.0	301.0	124.0
Indian Health Service	15.0	16.0	21.0	23.0	24.0	24.0	48.0	26.0
Department of Defense	12.4	21.4	23.3	24.1	18.5	19.6	20.9	21.5
Department of Interior (BIA)	0.0	0.0	0.0	0.0	0.0	0.0	5.0	0.0
Veterans Administration 6/	55.2	55.8	65.1	67.7	69.7	66.7	79.6	72.2
Subtotal, Drug Abuse Treatment	237.3	200.2	226.4	230.8	235.2	227.3	454.5	243.7
TOTAL, FEDERAL DRUG SUMMARY								
	1230.7	1384.5	1620.2	1962.6	2233.3	2269.6	3931.2	3033.2

FEDERAL DRUG CONTROL BUDGET
(Budget Authority -- \$ Millions)

<u>Agency/Account</u>	<u>1989</u> (enacted)	<u>1990</u> (prop.)
<u>Drug Law Enforcement:</u>		
Drug Czar	1.2	4.0
Special Forfeiture Fund	0.0	45.3
Department of Justice		
* Drug Enforcement Admin.	532.3	549.0
* FBI	129.3	91.4
Organized Crime Drug		
Enforcement Task Force (OCDE)	0.0	214.9
Criminal Division	10.7	10.1
Tax Division	2.2	0.8
* U. S. Attorneys	141.4	113.2
* U. S. Marshals	123.9	151.0
Prisons	574.4	657.7
Support of Prisoners	58.4	79.4
* Immigration & Naturalization	109.2	89.0
Office of Justice Programs	154.3	119.1
Forfeiture Fund	326.0	337.0
INTERPOL	1.1	1.1
Inspector General	0.6	1.2
Department of Treasury		
* Customs	444.0	441.5
* IRS	68.3	55.6
* Alcohol, Tobacco & Firearms	8.8	1.2
Department of Transportation		
Coast Guard	632.9	689.9
FAA	0.1	11.0
National Highway Traffic		
Safety Admin.	0.4	4.0

* Included OCDE funds in FY 1989.

Department of State

International Narcotics Matters	101.0	115.0
AID (Direct)	12.7	10.6
USIA	1.0	1.0
Salaries & Expenses	5.0	0.0

Department of Agriculture

Agriculture Research Service	1.3	1.3
U. S. Forest Service	5.2	5.3

Department of Interior

Bureau of Land Management	1.3	6.8
U. S. Park Service	1.2	7.6
Bureau of Indian Affairs	6.0	9.0
Fish and Wildlife Service	0.4	0.4

Food and Drug Admin.	6.7	1.8
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Department of Defense	308.3	317.6
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<u>Subtotal, Drug Law Enforcement</u>	3,769.6	4,143.8
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Drug Abuse Prevention:

Drug Czar	1.2	4.0
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Special Forfeiture Fund	0.0	45.3
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Department of Justice

Drug Enforcement Admin.	2.2	2.2
Office of Justice Programs	11.5	45.5

Department of Transportation

FAA	4.2	10.7
National Highway Traffic Safety Admin.	0.0	5.0

Department of State	5.2	2.6
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Department of HHS	458.7	475.0
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Department of Defense	89.0	94.5
Department of Education	354.5	391.6
Department of Labor	5.7	3.7
Department of Interior Bureau of Indian Affairs	0.8	0.6
ACTION	7.9	5.9
<u>Subtotal, Drug Abuse Prevention</u>	940.8	1,086.7

Drug Abuse Treatment:

Drug Czar	1.2	4.0
Special Forfeiture Fund	0.0	45.3
Department of Justice		
Office of Justice Programs	17.0	0.2
Prisons	5.1	6.3
Department of HHS		
Alcohol, Drug Abuse & Mental Health Admin.	462.1	541.0
Indian Health Service	18.7	18.7
Department of Defense	23.0	23.0
Department of Interior Bureau of Indian Affairs	0.0	0.3
Department of Veterans Affairs	93.9	96.5
<u>Subtotal, Drug Abuse Treatment</u>	621.0	735.3
 <u>TOTAL, FEDERAL DRUG PROGRAMS</u>	 5,331.4	 5,965.9

Note: Totals may not add due to rounding.

DRUG ABUSE PREVENTION

Question. Please detail how the Bush Budget Request would allocate the \$1.1 billion increase for drug abuse prevention activities?

Answer. The President FY90 Budget includes a total of \$1.1 billion for drug abuse prevention activities, an increase of nearly \$150 million or 16% over FY89. The President's initiative includes:

- o \$35 million for new awards for a program of community partnership demonstration grants for drug abuse prevention;
- o \$25 million for a new drug prevention initiative: Urban Emergency Grants. These grants will award funds to a number of city school systems with the worst drug problems. Schools will have maximum flexibility to propose a mix of education, security, parent and student involvement and special programs for children with known drug problems;
- o \$367 million for the Drug-Free Schools and Communities program, an \$12 million increase over FY89, which provides grants to States for drug prevention education and to institutions of higher education to implement drug prevention education programs on campus; train teachers in the implementation of drug prevention education techniques; and fund a variety of other activities, including enforcement, to help young people understand why they must reject drugs;
- o an increase of \$36 million for basic and applied research on drug abuse (\$227 million in total);
- o \$83 million for demonstration grants to help prevent the spread of HIV among drug abusers;
- o \$72 million for the Office of Substance Abuse Prevention primarily for drug abuse prevention demonstrations which target high risk youth and pregnant women, as well as community technical information and information dissemination programs; and,
- o approximately \$45 million of the Department of Justice's \$150 million drug grant program to local governments for drug prevention activities.

DRUG CZAR

Question. Does the additional \$5 million requested for the new Director of Drug Control Policy represent an increase over the \$3.5 million appropriated for FY 1989? In other words, are you requesting \$8.5 million for the "Drug Czar" in FY 1990?

Answer. The President is requesting a total of \$12 million for the Drug Czar in FY 1990.

INTERNATIONAL DRUG CONTROL BUDGET

Question. Please provide this Committee with a detailed budget for "Operation Snowcap" (the drug eradication campaign being conducted in Peru) in FY 1989 and the proposed budget for FY 1990.

Answer. "Operation Snowcap" is a multi-facted and multi-country drug suppression and enforcement operation in South America. Current efforts are centered in Peru and Bolivia. Several agencies are involved including the Drug Enforcement Administration (DEA), the State Department, the Coast Guard, the Immigration and Naturalization Service, and the Department of Defense.

In FY 1989, DEA anticipates spending \$14 million on this program: \$7 million for operating expenses; \$3 million for aviation support; and \$4 million to retrofit and operate six helicopters. The retrofitting costs (\$2 million) are being covered by the Department of Justice Assets Forfeiture Fund.

DEA anticipates maintaining the same level of funding in FY 1990.

We will ask the other agencies involved in "Operation Snowcap" to provide you with the details of their budgets.

Question. Since worldwide availability of narcotics has continued to increase over the last several years, how do you justify requesting an increase in the budget of the State Department's Bureau of International Narcotics Matters by \$14 million to \$115 million? Why wouldn't that increase be better spent on prisons or on demand reduction programs?

Answer. The \$14 million increase you refer to is to intensify U.S. Government efforts to curtail global narcotics production and trafficking, which are the very causes of increased worldwide availability. Most of the increase will be used to operate and maintain an expanding interregional air fleet, for eradication and interdiction of our main enemy in Latin America--cocaine. We believe strongly in the importance of domestic demand reduction and law enforcement programs, as is evidenced in our other budget initiatives and funding of the FY 1989-1990 Anti-Drug Abuse Act. However, our priorities also call for attacking drugs at the source.

DEFENSE DEPARTMENT ANTI-DRUG BUDGET

Question. Is the \$300 million increase that is proposed for the involvement of the Defense Department in drug interdiction activities an increase over the \$300 million appropriated for FY 1989?

Answer. The \$317.6 million included in the Defense program for FY 1990 is in addition to the \$300 million appropriated in FY 1989. It reflects a continuation of DOD anti-drug activities.

Question. What exactly is the additional \$300 million for?

Answer. The Department of Defense is now in the process of determining the best use of FY 1989 and FY 1990 funds. They will inform the Congress of their plans prior to spending any of the funds.

BUREAU OF PRISONS

Question. The funding request for prisons is designed to reduce the overcrowding rate in Federal prisons by at least 50 percent by 1995. Why did you not submit a request that will eliminate overcrowding?

Answer. Completely eliminating overcrowding would be the ideal situation. However, given the difficulty involved in estimating future prisoner population levels, we must target an overcrowding level greater than zero to avoid overbuilding. By planning to significantly reduce, but not eliminate, the current overcrowding level, Federal prison officials will be able to provide a safe and humane environment for staff and inmates, and we will have avoided the risk of building more prisons than necessary.

As we reduce overcrowding to a 30 percent target, we will continue to analyze how overcrowding affects the operation of the Federal Prison System and determine whether future reductions are necessary.

QUESTIONS SUBMITTED BY SENATOR PETE V. DOMENICI

SEQUESTER CALCULATIONS

Question. Mr. Darman, you recently made public a table showing a comparison of estimated Gramm-Rudman-Hollings post-sequester levels with the Bush budget request. In this table, you assumed sequester percentages of 8.5 percent for defense and 8.4 percent for non-defense programs.

As I understand the calculations you made available, the post-sequester level for nondefense discretionary spending, both domestic and international, would exceed the FY 1989 funding levels in both cases. For nondefense discretionary spending, the post-sequester would be \$1.2 billion higher than the FY 1989 level, or \$178.3 billion after a sequester compared to \$177.1 billion in FY 1989. For international affairs spending, the post sequester level would be \$0.1 billion higher than the FY 1989 level, or \$16.4 billion after a sequester compared to \$16.3 billion in FY 1989.

1. Would you explain why estimated spending in a Gramm-Rudman-Hollings post-sequester situation would exceed spending levels in the current fiscal year?

It seems to this Senator that spending should, in fact, decline below the FY 1989 level under a sequester calculation where the Gramm-Rudman-Hollings baseline is adjusted for inflation of approximately 4 percent, and then reduced by 8.4 percent under a sequester scenario.

2. Would you please provide for the record, consistent with the information you recently released comparing the Bush budget request to the post-sequester levels, two tables found in Special Analysis A of the budget showing the composition of baseline outlays for purposes of sequestration and sequestration calculations for FY 1990? These are tables A-18 and A-19 in the Special Analyses of the Budget, which appear on pages A-46 and A-47 of that volume.

Answer. Outlays in a given year are comprised of outlays from new budgetary resources for that year and outlays from prior year authority. Although the G-R-H baseline provides about a 4 percent increase in new

budget authority (and other budgetary resources) above the 1989 enacted levels for nondefense discretionary programs, only part of this increase translates into 1990 outlays. The rest of the outlays occur in subsequent years. Thus, outlays from new budgetary resources increase by only 1.2 percent between 1989 enacted and 1990 G-R-H baseline levels. Similarly, a sequester only applies to new budgetary resources and their associated outlays. The sequester is further limited to sequesterable programs and activities. For nondefense discretionary, only \$92 billion of the \$105 billion in outlays from new authority is subject to sequester. None of the \$98 billion in outlays from prior-year authority is reduced by a sequester.

The simple explanation is that less than half of total nondefense discretionary outlays is reduced by the 8.4 percent sequester (of \$203 billion in G-R-H baseline outlays for nondefense discretionary programs, only 45 percent--\$92 billion--are subject to sequester). Since outlays from prior-year authority grow by 9.4 percent between 1989 and 1990 under the G-R-H baseline, the 8.4 percent reduction applied to sequesterable outlays from new authority is not sufficient to offset the growth in outlays from prior-year authority and outlays from exempt nondefense discretionary programs. The attached table illustrates this point.

Discretionary Nondefense -- 1989 and 1990 Baselines
(Dollar amounts in billions)

	1989 Enacted Level	1990 O-B-B Baseline	Percent Change 1989-1990	Sequester Reduction (0.4%)	Post-Seq. O-B-B Baseline
International:					
Budget Authority.....	10.9	10.2	-0.4%	1.9	12.7
Sequesterable.....	(n/a)	(10.2)		(1.9)	(12.0)
Outlays:					
From New Authority.....	10.0	9.2	-7.7%	0.9	9.9
Sequesterable.....	(n/a)	(9.2)		(0.9)	(9.4)
From Prior Authority.....	0.9	7.0	25.6%	0.0	7.0
Total outlays.....	10.9	17.2	5.2%	0.0	16.4
Domestic:					
Budget Authority.....	143.4	150.0	4.6%	11.6	155.4
Sequesterable.....	(n/a)	(155.4)		(11.6)	(123.0)
Outlays:					
From New Authority.....	94.0	94.0	1.0%	7.1	99.5
Sequesterable.....	(n/a)	(92.0)		(7.1)	(73.0)
From Prior Authority.....	93.0	99.6	6.1%	0.0	99.6
Total outlays.....	177.1	195.6	4.9%	7.1	178.3
Spending rate plug.....		0.4			
Total outlays with plug....		196.1			
Total Nondefense Discretionary:					
Budget Authority.....	161.7	160.2	4.0%	13.1	155.1
Sequesterable.....	(n/a)	(153.0)		(13.1)	(140.5)
Outlays:					
From New Authority.....	104.0	105.2	1.2%	7.9	97.0
Sequesterable.....	(n/a)	(91.0)		(7.9)	(81.4)
From Prior Authority.....	99.3	97.7	0.4%	0.0	97.7
Total outlays.....	193.4	203.0	5.0%	7.9	194.7
Spending rate plug.....		0.4			
Total outlays with plug....		203.8			

March 2, 1989

COMPOSITION OF FEBRUARY B-R-H BASELINE OUTLAYS FOR 1990
(in billions of dollars)

	Estimate	Percent of Total
Defense: 1/		
Subject to across-the-board reduction.....	190.1	18.1
Exempt from sequestration.....	106.3	9.0
Subtotal, defense programs.....	296.4	25.1
Nondefense programs:		
Subject to sequestrations:		
Certain programs with automatic spending increases.....	1.3	0.1
Programs subject to special rules.....	124.0	10.5
Subject to across-the-board reduction.....	109.4	9.2
Subtotal, subject to sequestration.....	234.8	19.8
Exempt from sequestrations:		
Social security.....	244.8	20.7
Federal retirement, disability, and workers com- pensation.....	66.0	5.6
Earned income tax credit.....	3.8	0.3
Low-income programs.....	79.9	6.8
Veterans compensation and pensions.....	15.4	1.3
State unemployment benefits.....	14.0	1.2
Offsetting receipts.....	-63.0	-5.3
Net interest.....	174.1	14.7
Other.....	117.2	9.9
Subtotal, exempt from sequestration.....	852.0	75.1
Subtotal, nondefense programs.....	886.8	74.9
Total.....	1,183.0	100.0
Memorandum:		
Defense with military personnel accounts protected:		
Subject to across-the-board reduction.....	134.3	11.4
Exempt from sequestration.....	161.9	13.7

1/ Excludes Federal Emergency Management Agency accounts.

March 2, 1989

SEQUESTRATION CALCULATIONS FOR 1990 FEBRUARY O-R-H BASELINE
(in billions of dollars)

	<u>Estimate</u>
Required deficit reduction.....	23.0
Defense Programs: 1/	
Total required outlay reductions.....	11.5
Estimated outlays associated with across-the-board sequesterable budgetary resources.....	190.1
Uniform reduction percentage.....	6.0
Nondefense programs:	
Total required outlay reductions.....	11.6
Estimated savings from automatic spending increases.....	*
Estimated savings from the application of special rules:	
Guaranteed student loans.....	*
Foster care and adoption assistance.....	*
Medicare.....	1.5
Other health programs.....	0.2
Amount remaining to be obtained from uniform percentage reductions of budget resources.....	9.7
Estimated outlays associated with across-the-board sequesterable budgetary resources 2/.....	116.0
Uniform reduction percentage.....	<u>8.4</u>
Memorandum:	
Defense with military personnel accounts protected:	
Total required outlay reductions.....	11.6
Estimated outlays associated with across-the-board sequesterable budgetary resources.....	134.5
Uniform reduction percentage.....	<u>8.5</u>

1/ Excludes Federal Emergency Management Agency accounts.

2/ Includes \$6.6 billion in estimated 1991 outlays for the Commodity Credit Corporation that can be affected by a 1990 sequester and \$3.0 billion in outlays from offsetting collections.

* \$80 million or less.

QUESTION SUBMITTED BY SENATOR DON NICKLES

LEGISLATIVE BRANCH APPROPRIATIONS

Question. It is my understanding that under current law, the Administration does not develop the budget proposal for items under the Legislative Branch appropriations jurisdiction. But, you are required to package them with your budget and send them to Congress. With this in mind, what are your comments with respect to the items under the legislative branch jurisdiction?

Items requesting specific comment:

Official mail: FY89 enacted - \$ 53,926,000
FY90 request - \$134,000,000

Architect of the Capitol:

FY89 enacted - \$103,640,000
FY90 request - \$166,159,000
(60+% increase)

Answer. Senator, your understanding is correct. Under 31 U.S.C. 1105(b), shown below, the President is required to include the budget proposal of the Legislative Branch in his budget, without change:

(b) Estimated expenditures and proposed appropriations for the legislative branch and the judicial branch to be included in each budget under subsection(a)(5) of this section shall be submitted to the President before October 16 of each year and included in the budget by the President without change.

In light of the fiscal restraint that must be exercised to meet the Gramm-Rudman-Hollings deficit targets, the Reagan budget recommended an overall adjustment to the Legislative Branch FY 1990 budget proposal of roughly \$300 million in reductions to both budget authority and outlays. For purposes of starting the budget process with the Congress, the Reagan budget proposals for those programs that have not been identified as Bush budget priorities--and this would include the Legislative Branch request--should be treated as if they were Bush Administration proposals.

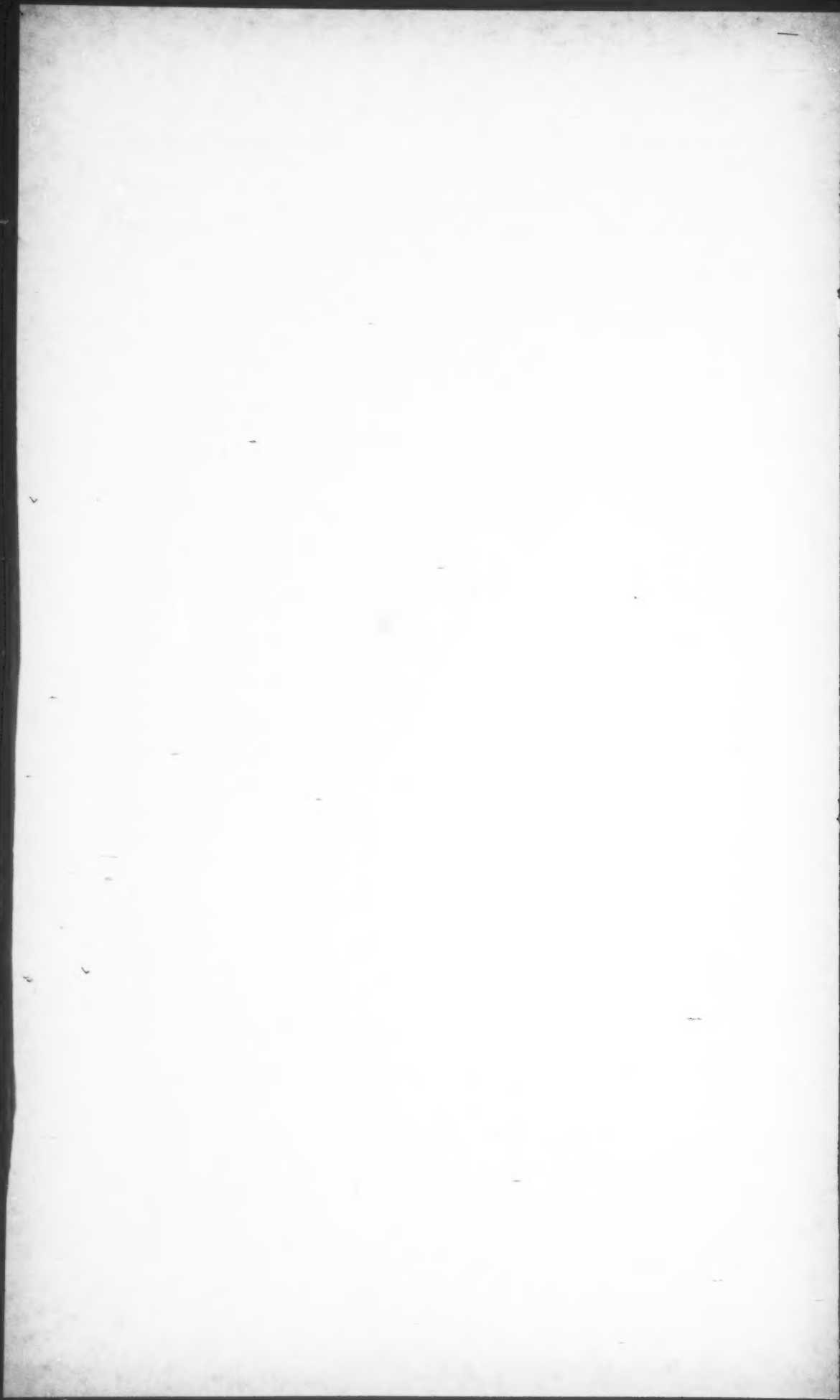
Since the Executive Branch has no policy or programmatic role in the development of the Legislative Branch budget proposal, OMB has no comment on the FY 1990 requests for official mail costs and the Architect of the Capitol.

COMMITTEE RECESS

Senator REID. The committee stands in recess subject to the call of the Chair. Thank you very much for your attention.

Mr. DARMAN. Thank you very much, Mr. Chairman. I appreciate it, and I appreciate your letting me go. Thank you.

[Whereupon, at 1:50 p.m., Tuesday, February 28, the committee recessed, to reconvene at 9:30 a.m., Tuesday, March 7.]



BUDGET OVERVIEW FOR FISCAL YEAR 1990

TUESDAY, MARCH 7, 1989

U.S. SENATE,
COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The committee met at 9:30 a.m. in room SD-192, Dirksen Senate Office Building, Hon. Robert C. Byrd (chairman) presiding.

Present: Senators Byrd, Johnston, Sasser, Bumpers, Mikulski, Adams, Kerrey, Hatfield, McClure, Garn, Specter, Domenici, and Grassley.

DEPARTMENT OF THE TREASURY

STATEMENT OF NICHOLAS F. BRADY, SECRETARY

The CHAIRMAN. The committee will come to order.

The committee is pleased this morning to welcome Secretary of the Treasury, Nicholas Brady.

Mr. Secretary, if you would like to proceed with your opening statement, you may read it in its entirety, or you may hit the highlights and we will insert the statement in the record in its entirety, whichever way you prefer.

Secretary BRADY. Mr. Chairman, if I may, why do not I hit a few of the highlights and if it is a little disjointed, I apologize, but I will try to foreshorten it to some extent.

OPENING STATEMENT

Chairman Byrd, members of the committee, I am pleased to be here today to discuss with you President Bush's proposed fiscal year 1990 budget. I know that you have already heard from the Director of the Office of Management and Budget, Richard Darman, so in my testimony I will not repeat a detailed presentation of the his remarks.

The approach to the budget I wish to take today is from the perspective of overall economic policy, thus, I will discuss the importance of deficit reduction to the continued vitality and strength of our economy and the maintaining and improving of our position in the world economy as well.

We are all aware that we continue to be in a period of extraordinary expansion which has produced millions of jobs, while reducing inflation. We must be equally aware that to sustain this expansion we must reduce the deficit.

As you know, a week ago the Federal Reserve raised the discount rate 0.5 percent to 7 percent. I would like to say a few words about that. First, and foremost, the Bush administration and the Federal

Reserve share absolutely a firm commitment to fighting inflation. However, it is possible to have somewhat different interpretations of the same economic statistics, to think one set of statistics means more than another, and still share the same goal of fighting inflation.

The Federal Reserve is using the strongest weapon in its arsenal to fight inflation to advance the cause of the long-term strength and vitality of our economy. The strongest weapon we in the Government have to further the cause of our long-term economic strength is deficit reduction. We must all do our parts. Even to delay action costs us in terms of interest rates, jobs, the savings and loan crisis, and the third world debt problem.

The Bush administration is absolutely committed to working with you to reduce the deficit. But, some have questioned our economic assumptions. First, I would like to point out that historically the executive branch's economic assumptions have not had a consistent bias toward a rosy scenario. In fact, in the last 7 years, the administration underestimated growth four times and overestimated it three.

For this year, we believe that the economy will continue to grow, but at a slightly slower pace than last year's drought-adjusted rate. We are projecting that GNP will grow 3.5 percent next year. But when we exclude the impact of the rebound from the drought, our forecast is for a moderate 2.8-percent growth rate. This is slower than last year's 3.4-percent drought-adjusted growth rate. Our long-term forecast for a 3.2-percent sustainable growth rate is right in line with our experience over the past 40 years, during which real GNP growth averaged 3.3 percent.

INTEREST RATE ASSUMPTIONS

As one who worked for over 30 years in financial markets, may I make a few comments on interest rate assumptions. During my first year in business, 1954, 10-year Government bonds carried an interest rate of 2.4 percent. They reached 14 percent in 1981. These same 10-year Government bonds were 12.4 percent as recently as 1984, but declined to 7.7 percent in 1986. They now carry an interest rate of about 9.3 percent.

Attached as an exhibit to my testimony is a graph showing the decline in rates surrounding the passage of Gramm-Rudman-Hollings. For 3½ months prior to the passage of this all-important fiscal legislation until 3½ months after, interest rates declined 300 basis points. Was it the only cause of this rapid decline in interest rates? No. Was it the principal cause? Yes.

This would indicate to me that while there is plenty of room for honest disagreement about the future level of interest rates, there is some evidence that fiscal actions have an effect on interest rates, particularly long-term rates. My conclusion is that investors and savers all over the world are waiting for a sign from our Government that we are committed to fiscal prudence and are willing to do something about it. Delay in reaching a budget agreement may only maintain the current high level of interest rates and cost the United States and the world unnecessary pain.

In sum, do I think our economic assumptions will prove true if we do not reduce the deficit? No. Will they prove accurate if we do? Yes; I believe so.

I know that you have heard a great deal about specific proposals in our budget from Director Darman. I would simply like to reiterate the fundamental point that, within the confines of meeting the Gramm-Rudman-Hollings target, the President has proposed budget priorities which, if adopted, will make a significant investment in our country's future.

SAVINGS AND LOAN

Now if I may just give a little detail on the savings and loan solution, because it is something that is up before the Congress at this moment.

The President's budget contains the funding required to resolve the savings and loan crisis. It has three components. The first part consists of \$50 billion to resolve currently solvent institutions which may become insolvent over the next several years.

Second, the plan ensures adequate servicing of the \$40 billion in past FSLIC obligations. And third, and perhaps most important, the plan provides \$33 billion in financial resources necessary to put S&L deposit insurance on a sound financial basis.

At the heart of our plan is the creation of the Resolution Trust Corporation, for which the FDIC will be the primary manager, directed to resolve all S&L's which are now insolvent or become so over the next 3 years.

To provide the \$50 billion to the RTC, we will create a new, separate, privately owned corporation, the Resolution Funding Corporation, REFCORP so-called, which will issue \$50 billion in long-term bonds to raise the needed funds. To pay the principal, industry funds will be used to purchase zero-coupon, long-term Treasury securities which will grow through compound interest to maturity value of \$50 billion. This assures the repayment of the principal of the bonds issued by REFCORP. Funds to purchase these zero-coupon bonds will come exclusively from private sources.

The Federal Home Loan Banks will contribute about \$2 billion of their retained earnings which are currently allocated to, but not needed by, the existing Financing Corporation [FICO], plus approximately 20 percent of their annual earnings, or \$300 million a year in each 1989, 1990, and 1991.

The S&L's will contribute a portion of their insurance premiums; and if necessary, proceeds from the sale of FSLIC receivership assets will be used. No Treasury funds or guarantees will be used to repay any REFCORP principal.

Interest payments on the REFCORP bonds will come from a combination of private sources. The Federal Home Loan Banks, beginning in 1992, will contribute \$300 million a year. The RTC will contribute a portion of the proceeds generated from the sale of receivership assets, and proceeds from warrants and equity participations taken in resolutions. And the Treasury will make up any shortfall. All Treasury funds used to service REFCORP interest will be scored for budget purposes in the year expended.

Funds for the second component of our plan—servicing the cost of the \$40 billion in resolutions already completed by FSLIC—also will come from a combination of industry and taxpayer sources. FICO will issue bonds under its remaining authority and contribute the proceeds. The S&L's will contribute a portion of their insurance premiums. FSLIC will contribute the proceeds realized from the sale of receivership assets taken in already completed resolutions, as well as miscellaneous income. And again, the Treasury will be used to make up any shortfall.

Final component of the plan is managing future S&L insolvencies and building the Savings Association Insurance Fund [SAIF], the new S&L insurance fund, during the post-RTC period. The funding will come from a portion of the S&L's, insurance premiums and Treasury funds, as needed.

These sources provide about \$3 billion per year to handle any insolvencies which occur in the 1992-99 period and in addition contribute at least \$1 billion per year to building the new Savings Association Insurance Fund. Overall the plan contains \$33 billion in post-RTC funds from 1992 to 1999 to manage future insolvencies and contribute to building a healthy new S&L insurance fund. Assuming that \$24 billion is used for post-RTC resolutions, by 1999 the SAIF fund will still contain just under \$9 billion at a minimum to support the healthy S&L's.

The net impact of the entire plan which includes paying for completed S&L resolutions, paying for the S&L resolutions still to be completed, and providing for fully funded insurance funds for both commercial banks and thrifts is \$1.9 billion in fiscal years 1990 and \$39.9 billion over the next 10 years.

INFLUENCE OF FOREIGN FINANCIAL MARKETS

I would like to skip to my final paragraph, Mr. Chairman, which deals with the international aspects of our considerations today, and simply state the following. A new reality and an international implication of our work is that there are no more international boundaries when it comes to the flow of dollars. No border control, no customs officials, and no barriers. The influence of foreign financial markets on our economy is great and deep.

Most of the world's dollar financial transactions settle daily through New York. Before the advent of instantaneous transfer of information and electronic funds transfers, this settling of accounts would have taken weeks, if not longer. Now it occurs every night.

There are two wires through which the transactions settle. The CHIPS wire which largely handles international transactions, and the Fed wire which handles mostly, but not exclusively, domestic transactions. Last month on average about \$735 billion worth of transactions were settled per day on the CHIPS wire. And the level of activity is increasing on average at a rate of 25 percent a year, to give you some idea how important international transactions are to all of us.

If you approximate the international transactions in addition which settle via the Fed wire, then there are about \$1 trillion of international transactions settled every day on these wires. This

amounts to \$5 trillion a week, in other words, greater each week than our yearly gross national product.

Another statistic which demonstrates the power of international finance on our economy is that at the end of 1987 the recorded stock of U.S. assets held by foreigners was almost \$400 billion greater than the stock of foreign assets held by Americans. Ten years ago this difference was \$50 billion in our favor. While one can have different views of how to interpret these numbers, one point is clear, we cannot ignore the effect of international markets on our balance of payments when considering the need for deficit reduction.

Both the flow of financial transactions through the Fed wire and CHIPS and the amount of U.S. assets held by foreigners are, in a sense, a measure of the foreign confidence in our ability to maintain a sound economy and reduce our budget deficit. The tally of the world's opinion of our progress is registered every day through the Federal Reserve. It is vital that we act decisively to preserve that confidence.

Lest there be any doubt about the extent of the world's interest and concern about the deficit, may I share with you some of the feelings of my G-7 colleagues who I met here in Washington the first week in February and who will meet again in early April here in Washington.

We are engaged in a team effort, the economic policy coordination process, to provide a growing world economy. I have been pressing them on behalf of the United States to stimulate their economies and open their markets to sustain world economic growth. They, in turn, are deeply concerned about our ability to reduce the deficit. They worry that we lack the strength of purpose to meet the Gramm-Rudman-Hollings target. They are knowledgeable about the details of our budget process and are watching very carefully how we handle our budget negotiations. They are concerned that our commitment to abiding by the current Gramm-Rudman targets is less than firm and unequivocal, that if meeting the \$100 billion target becomes too onerous that we will move the goal line.

I assured them on behalf of all of us, both the executive and legislative branches alike, that we are firmly and absolutely committed to meeting the deficit-reduction target. I have told them that we will get there one way or the other. I know you share this commitment. I am delighted to be here today to discuss with you how we can achieve this common goal.

[The statement follows:]

STATEMENT OF SECRETARY NICHOLAS F. BRADY

Chairman Byrd, Senator Hatfield and members of the Committee, I am pleased to be here today to discuss with you President Bush's proposed fiscal year 1990 budget. I know that you have already heard from the Director of the Office of Management and Budget, Richard Darman, so in my testimony I will not repeat a detailed presentation of the Bush budget.

The approach to the budget I wish to take today is from the perspective of overall economic policy, thus, I will discuss the importance of deficit reduction to the continued vitality and strength of our national economy and to maintaining and improving our position in the world economy.

We are all aware that we continue to be in a period of extraordinary economic expansion, which has produced millions of jobs, while reducing inflation. We must equally be aware that to sustain this expansion we must reduce the deficit.

The Federal Reserve is using the strongest weapon in its arsenal to fight inflation to advance the cause of the long-term strength and vitality of our national economy. The strongest weapon we in the government have to further the cause of our long-term economic strength is deficit reduction. We must do our part. Even to delay action costs us—in terms of interest rates, jobs, the Savings and Loan crisis, the third world debt problem.

Let us be frank with one another. We are constrained between revenue levels which are the result of the 1988 election which validated President's Bush's commitment to "No new taxes" and a Gramm-Rudman-Hollings maximum deficit level of \$100 billion prescribed in law. So, there are not funds to do all that we want.

Stepping back from the roar of the budget discussions for a minute, one could say, "This is where the country wants us to operate." The key is to have the American people say, "They did what we wanted with what we gave them."

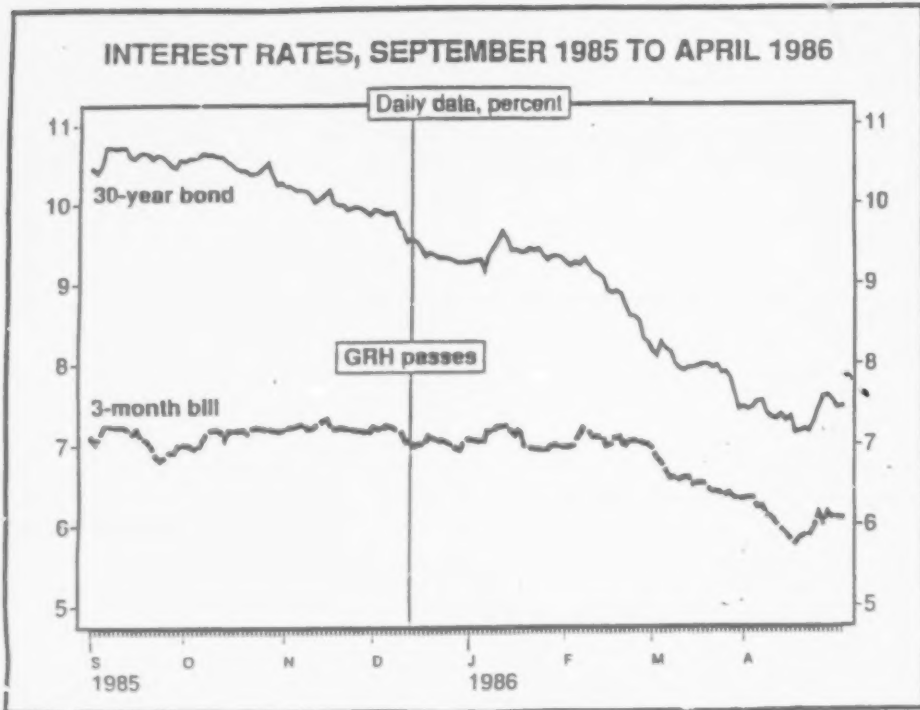
ECONOMIC ASSUMPTIONS

The Bush Administration is absolutely committed to working with you to reduce the deficit. But, some have questioned our economic assumptions. First, I would like to point out that historically the executive branch's economic assumptions have not had a consistent bias toward a rosy scenario. In fact, in the last seven years, the Reagan Administration underestimated growth four times and overestimated it three.

For this year, we believe that the economy will continue to grow, but at a slightly slower pace than last year's drought adjusted rate. We are projecting that GNP will grow 3.3 percent next year. But when we exclude the impact of the rebound from the drought, our forecast is for a moderate 2.8 percent growth rate. This is slower than last year's 3.4 percent drought adjusted growth rate. Our long term forecast for a 3.2 percent sustainable growth rate is right in line with our experience over the past 40 years, during which real GNP growth averaged 3.3 percent.

As one who worked for over 30 years in financial markets, may I make a few comments on interest rate assumptions. During my first year in business, 1954, ten-year government bonds carried an interest rate of 2.4 percent. They reached 14 percent in 1981. These same ten-year government bonds were 12.4 percent as recently as 1984, but declined to 7.7 percent in 1986. They now carry an interest rate of about 9.3 percent.

Attached as an exhibit to my testimony is a graph showing the decline in rates surrounding the passage of Gramm-Rudman-Hollings. From three and one-half months prior to the passage of this all-important fiscal legislation until three and one-half months after, interest rates declined 300 basis points. Was it the only cause of this rapid decline in interest rates? No. Was it a principal cause? Yes.



This would indicate to me that while there is plenty of room for honest disagreement about the future level of interest rates, there is some evidence that fiscal actions have an effect on interest rates, particularly long-term rates. My conclusion is that investors and savers all over the world are waiting for a sign from our government that we are committed to fiscal prudence, and are willing to do something about it. Delay in reaching a budget agreement may only maintain the current high level of interest rates and cost the U.S. and the world unnecessary pain.

In sum, do I think our economic assumptions will prove true if we don't reduce the deficit? No. Will they prove accurate if we do? I believe so.

I know that you have heard a great deal about the specific proposals in our budget from Budget Director Darman. I would simply like to reiterate the fundamental point that, within the confines of meeting the Gramm-Rudman-Hollings target, the President has proposed budget priorities which if adopted will make a significant investment in our country's future.

THE SAVINGS AND LOAN SOLUTION

The President's budget contains the funding required to resolve the Savings and Loan crisis. It has three components. The first part consists of \$50 billion to resolve currently solvent institutions which may become insolvent over the next several years. Secondly, the plan ensures adequate servicing of the \$40 billion in past FSLIC obligations.

And third, and perhaps most important, the plan provides \$33 billion in financial resources necessary to put S&L deposit insurance on a sound financial basis for the future.

At the heart of our plan is the creation of a Resolution Trust Corporation (RTC), for which the FDIC will be the primary manager directed to resolve all S&Ls which are now insolvent or become so over the next three years.

To provide the \$50 billion to the RTC, we will create a new, separate, privately-owned corporation, the Resolution Funding Corporation (REFCORP), which will issue \$50 billion in long-term bonds to raise the needed funds. To pay the principal, industry funds will be used to purchase zero-coupon, long-term Treasury securities which will grow through compound interest to a maturity value of \$50 billion. This

assures the repayment of the principal of the bonds issued by REFCORP. Funds to purchase these zero-coupon bonds will come exclusively from private sources:

- The FHLBanks will contribute about \$2 billion of their retained earnings—which are currently allocated to, but not needed by, the existing Financing Corporation (FICO)—plus approximately 20 percent of their annual earnings, or \$300 million, in 1989, 1990 and 1991;

- The S&Ls will contribute a portion of their insurance premiums; and

- If necessary, proceeds from the sale of FSLIC receivership assets will be used. No Treasury funds or guarantees will be used to repay any REFCORP principal.

Interest payments on the REFCORP bonds will come from a combination of private and taxpayer sources:

- The FHLBanks, beginning in 1992, will contribute \$300 million a year;

- The RTC will contribute a portion of the proceeds generated from the sale of receivership assets, and proceeds from warrants and equity participations taken in resolutions; and

- Treasury funds will make up any shortfall.

All Treasury funds used to service REFCORP interest will be scored for budget purposes in the year expended.

Funds for the second component of our plan—servicing the cost of the \$40 billion in resolutions already completed by FSLIC—also will come from a combination of S&L industry and taxpayer sources:

- FICO will issue bonds under its remaining authority and contribute the proceeds;

- The S&Ls will contribute a portion of their insurance premiums;

- FSLIC will contribute the proceeds realized from the sale of receivership assets taken in already completed resolutions, as well as miscellaneous income; and

- Treasury funds will be used to make up any shortfall.

The final component of the plan is managing future S&L insolvencies and building the Savings Association Insurance Fund (SAIF), the new S&L insurance fund, during the post-RTC period. The funding will come from a portion of S&Ls' insurance premiums and Treasury funds as needed.

These sources provide about \$3 billion per year to handle any insolvencies which occur in the 1992-99 period and in addition contribute at least \$1 billion per year to building the new Savings Association Insurance Fund. Overall the plan contains \$33 billion in post-RTC funds from 1992 to 1999 to manage future insolvencies and contribute to building a healthy new S&L insurance fund. Assuming that \$24 billion is used for post-RTC resolutions, by 1999 the SAIF fund will still contain just under \$9 billion at a minimum to support the healthy S&Ls.

The net impact of the entire plan—which includes paying for completed S&L resolutions, paying for the S&L resolutions still to be completed, and providing for fully funded insurance funds for both commercial banks and thrifts—is \$1.9 billion in FY90 and \$39.9 billion over the next 10 years.

CAPITAL GAINS

The President's budget includes important revenue-related measures that fall within the jurisdiction of the Treasury Department. These measures also directly reflect the President's commitment to a budget that sustains a strong economy and builds upon it to enhance our future economic power.

We propose a major tax initiative designed to enhance America's long-term growth and competitiveness: a reduction and restructuring of the capital gains tax to encourage long-term investment. Our proposal calls for a 5-percent exclusion of long-term gains or a 15 percent tax rate cap, whichever is more advantageous to the taxpayer. As an important part of this plan, we have targeted the greatest relative benefits to those with incomes lower than \$20,000, if married, and \$10,000 if single. Such taxpayers would be eligible for a 100 percent exclusion—no tax at all on long-term capital gains.

The policy of a lower tax rate for capital gains was first established in the Revenue Act of 1921. This policy remained in effect for 65 years. During this time it was endorsed by Democrats and Republicans alike as an important means of stimulating investment. The Tax Reform Act of 1986 eliminated that differential in 1987. In my judgment, the benefits of a lower capital gains tax merit its reinstatement. It is important for the long-term strength of our economy that our tax laws encourage saving and investment in entrepreneurial activities. I believe the essential benefit of a reduction in the capital gains tax goes beyond simply encouraging short-term investment and growth. Over the next four years, we propose to phase in a three-year

holding period for capital assets sold to qualify for the lower capital gains tax rates. Thus we want to shift the focus of investors from the short-term to the long-term, because ultimately, it is long-term investment which will provide our economy with its fundamental strength. Thus we propose to restore this long-acknowledged incentive to American enterprise.

Enhancing incentives for long-term investment is not the only area in which we need to act if the United States is going to remain a leader in the world economy. It is equally important that we take steps to augment policies and programs which stimulate research and development and which foster our long-term productive capacity.

To this end, the President's budget increases investment in basic research by increasing funding for science and technology programs by 13 percent over the enacted 1989 funding levels. Furthermore, we propose to make the tax credit for research and experimentation permanent. For a number of years, we have had a temporary tax credit to encourage additional research and experimentation (R&E) by U.S. industry. The current credit expires at the end of 1989. It's time we stopped sending stop and go signals to the business community on the importance of research to our economic strength.

Accordingly, the President has proposed to make this credit a permanent feature of the landscape so that U.S. corporations can make their R&E plans with a longer horizon. With this same purpose in mind, the President has also proposed a permanent and more beneficial formula for the allocation of RFE expenses between domestic and foreign income.

INTERNATIONAL CONTEXT

Improving our competitive position in the world economy is very important to our future international economic position. Reducing the deficit will not only improve our competitive position, but is of vital importance to our overall international economic standing. I wish to take a few minutes to address the international implications of our work on the budget this year.

The new reality is that there are no more international boundaries when it comes to the flow of dollars—no border control, no customs officials and no barriers. The influence of foreign financial markets on our economy is great and deep. Most of the world's dollar financial transactions settle daily through New York. Before the advent of instantaneous transfer of information and electronic funds transfers this settling of accounts would have taken weeks, now it occurs every night. There are two "wires" through which the transactions settle. The CHIPS wire which largely handles international transactions, and the Fed wire which handles mostly, but not exclusively, domestic transactions. Last month on average about \$735 billion worth of transactions were settled per day on the CHIPS wire. And the level of activity is increasing on average at a rate of 25 percent a year. If you approximate the international transactions settled via the Fed wire, then there are about \$1 trillion of international transactions settled every day on these wire systems. This amounts to \$5 trillion a week, in other words greater each week than our yearly GNP.

Another statistic which demonstrates the power of international finance on our economy is that at the end of 1987 the recorded stock of U.S. assets held by foreigners was almost \$400 billion greater than the stock of foreign assets held by Americans. Ten years ago this difference was \$50 billion in our favor. While one can have different views of how to interpret those numbers, one point is clear—we cannot ignore the effect of international markets on our balance of payments when considering the need for deficit reduction.

Both the flow of financial transactions through the Fed wire and CHIPS and the amount of U.S. assets held by foreigners are in a sense a measure of foreign confidence in our ability to maintain a sound economy and reduce our budget deficit. The tally of the world's opinion of our progress is registered every day through the Federal Reserve's wires. It is vital that we act decisively to preserve that confidence.

Lest there be any doubt about the extent of the world's interest and concern about the deficit, let me share with you some of the feelings of my G-7 colleagues—who met here in Washington, DC the first week in February. We are engaged in a team effort, the economic policy coordination process, to provide a growing world economy. I have been pressing them to stimulate their domestic economies and open their markets to sustain world economic growth. They, in turn, are deeply concerned about our ability to reduce the deficit. They worry that we lack the strength of purpose to meet the Gramm-Rudman-Hollings target. They are knowledgeable about the details of our budget process and are watching very carefully how we handle our budget negotiations. They are concerned that our commitment to abide

ing by the current Gramm-Rudman targets is less than firm and unequivocal, that if meeting the \$100 billion target becomes too onerous that we will move the goal line. I assured them on behalf of us all that people in this government—executive and legislative branches alike—are firmly and absolutely committed to meeting the deficit reduction target. I have told them that we will get there one way or the other.

I know you share this commitment. I am delighted to be here today to discuss with you how we can achieve this common goal.

S&L COST TO TAXPAYERS

The CHAIRMAN. Thank you, Mr. Secretary. There are many critical issues facing the Nation and which come directly under the jurisdiction of the Secretary of the Treasury. Today, there are two issues facing us which have a huge impact on the deficit and on the American people.

First is the administration's proposal to bail out bankrupt savings and loans. On February 6, Mr. Brady, the President held a press conference to unveil the administration's proposal. And I want to commend you for addressing in your proposal important improvements in the regulation of the savings and loan industry. And never again should the American people be forced to pick up the tab for the industry's mistakes. You use the words "never again" in a number of instances, and I compliment you.

And so I am using them also to say never again should the American people be forced to pick up the tab for the industry's mistakes—whether they were caused by bad investment decisions, the effects of a recession, or outright fraud. The taxpayers played no part in creating this massive drain on the Treasury, and they do not deserve to have to pay for it.

I was also glad to see that your proposal would strengthen the enforcement of the industry. The regulators must be equipped to strike quickly to uncover and eliminate fraud and to correct abuses before more institutions sink into bankruptcy. The increase in the civil penalty for violators of the law from \$1,000 to \$1 million is a welcome change. Somebody ought to go to jail for this reprehensible bilking of the taxpayers.

But, while the administration deserves credit for certain aspects of the proposal, there seems to me to be one glaring deficiency in it, and that is the lack of clarity on its true cost to the taxpayers. In your February 6 press conference, you indicated that the total cost of the bailout would be \$126 billion. Of that amount, you said the Treasury would have outlays of about \$40 billion over the next 10 years. Then 2 weeks later, you revised the figure to \$157 billion, an increase of 25 percent, or \$31 billion, while stating that the Treasury share would not go up at all.

Yet, an analysis by the Senate Budget Committee estimates that even using your own highly optimistic forecasts on interest and GNP growth over the next 10 years, the real cost to the taxpayers is \$76.8 billion, nearly double your figure. On March 3, the Congressional Budget Office testified before the Senate Banking Committee that the 10-year cost to the Treasury is \$84 billion, again using your own economic forecasts.

There are other estimates that place the cost much higher. Senator Heinz has produced a 30-year cost estimate of \$200 billion. Chairman Gonzalez, of the House Banking Committee, has issued a

report that sets the total 30-year cost at \$335 billion. His estimate of unfunded expenses totals \$183 billion, which would presumably have to be paid by the taxpayers. So I do not know which set of numbers is correct, but I am convinced that the cost to the taxpayers will end up far in excess of \$40 billion.

Another area of concern to me in the proposal is the idea that the borrowing to finance the bailout should be off-budget. And I understand the reasons for it, it is to avoid increasing the deficit. But the cost of financing the bonds off-budget versus Treasury borrowing, causes the interest costs on the bonds to be higher by at least \$125 million per year. In my view, that is a needless waste of tax dollars.

So, Mr. Brady, I hope you will shed some light on these problems. We need all the facts, and not just part of the picture.

Finally, I am concerned that the economic forecasts used by the administration in projecting the deficit for the next 5 years are overly optimistic. For fiscal year 1990 alone, if the Congressional Budget Office is correct and the administration is wrong on real GNP growth and interest rates, the deficit will be as much as \$20 billion higher than predicted by the administration.

I understand that macroeconomics is not a science. Experts can differ on these projections. But such wide variances in the deficit make it extremely difficult for this committee to proceed with any degree of certainty on funding the decisions for the entire Government.

[The statement follows:]

STATEMENT OF CHAIRMAN ROBERT C. BYRD

THE COMMITTEE IS PLEASED TO WELCOME SECRETARY OF THE TREASURY NICHOLAS BRADY. THERE ARE MANY CRITICAL ISSUES FACING THE NATION WHICH COME DIRECTLY UNDER THE JURISDICTION OF SECRETARY BRADY. TODAY, THERE ARE TWO ISSUES FACING US WHICH HAVE A HUGE IMPACT ON THE DEFICIT AND ON THE AMERICAN PEOPLE.

THE FIRST IS THE ADMINISTRATION'S PROPOSAL TO BAIL OUT BANKRUPT SAVINGS AND LOANS. ON FEBRUARY 6TH, MR. BRADY, THE PRESIDENT HELD A PRESS CONFERENCE TO UNVEIL THE ADMINISTRATION'S PROPOSAL. I WANT TO COMMEND YOU FOR ADDRESSING IN YOUR PROPOSAL IMPORTANT IMPROVEMENTS IN REGULATION OF THE SAVINGS AND LOAN INDUSTRY. NEVER AGAIN SHOULD THE AMERICAN PEOPLE BE FORCED TO PICK UP THE TAB FOR THE INDUSTRY'S MISTAKES--WHETHER THEY WERE CAUSED BY BAD INVESTMENT DECISIONS, THE EFFECTS OF A RECESSION, OR OUTRIGHT FRAUD. THE TAXPAYERS PLAYED NO PART IN CREATING THIS MASSIVE DRAIN ON THE TREASURY. THEY DON'T DESERVE TO HAVE TO PAY FOR IT.

I WAS ALSO GLAD TO SEE THAT YOUR PROPOSAL WOULD STRENGTHEN ENFORCEMENT OF THE INDUSTRY. THE REGULATORS MUST BE EQUIPPED TO STRIKE QUICKLY TO UNCOVER AND ELIMINATE FRAUD AND TO CORRECT ABUSES BEFORE MORE INSTITUTIONS SINK INTO BANKRUPTCY. THE INCREASE IN THE CIVIL PENALTY FOR VIOLATORS OF THE LAW FROM \$1,000 TO \$1 MILLION IS A WELCOME CHANGE. SOMEBODY OUGHT TO GO TO JAIL FOR THIS REPREHENSIBLE BILKING OF THE TAXPAYERS.

BUT, WHILE THE ADMINISTRATION DESERVES CREDIT FOR CERTAIN ASPECTS OF ITS PROPOSAL, THERE IS ONE GLARING DEFICIENCY IN IT--AND THAT IS THE LACK OF CLARITY ON ITS TRUE COST TO THE TAXPAYERS. MR. BRADY, IN YOUR FEBRUARY 6TH PRESS CONFERENCE, YOU INDICATED THAT THE TOTAL COST OF THIS BAILOUT WOULD BE \$126 BILLION. OF THAT AMOUNT, YOU SAID THE TREASURY WOULD HAVE OUTLAYS OF ABOUT \$40 BILLION OVER THE NEXT 10 YEARS. THEN TWO WEEKS LATER,

YOU REVISED THE FIGURE TO \$157 BILLION (AN INCREASE OF \$31 BILLION) WHILE STATING THAT THE TREASURY SHARE WOULDN'T GO UP AT ALL.

YET, AN ANALYSIS BY THE SENATE BUDGET COMMITTEE ESTIMATES THAT EVEN USING YOUR OWN HIGHLY OPTIMISTIC FORECASTS ON INTEREST AND GNP GROWTH OVER THE NEXT 10 YEARS, THE REAL COST TO THE TAXPAYERS IS \$76.8 BILLION--NEARLY DOUBLE YOUR FIGURE. ON MARCH 3RD, THE CONGRESSIONAL BUDGET OFFICE TESTIFIED BEFORE THE SENATE BANKING COMMITTEE THAT THE 10-YEAR COST TO THE TREASURY IS \$84 BILLION, AGAIN USING YOUR OWN ECONOMIC FORECASTS.

THERE ARE OTHER ESTIMATES THAT PLACE THE COST MUCH HIGHER. SENATOR HEINZ HAS PRODUCED A 30-YEAR COST ESTIMATE OF \$200 BILLION. CHAIRMAN GONZALEZ, OF THE HOUSE BANKING COMMITTEE, HAS ISSUED A REPORT THAT SETS THE TOTAL 30-YEAR COST AT \$335 BILLION. HIS ESTIMATE OF UNFUNDED EXPENSES TOTALS \$183 BILLION--WHICH WOULD PRESUMABLY HAVE TO BE PAID BY THE TAXPAYERS.

I DON'T KNOW WHICH SET OF NUMBERS IS CORRECT--BUT I AM CONVINCED THAT THE COST TO THE TAXPAYERS WILL END UP FAR IN EXCESS OF \$40 BILLION.

ANOTHER AREA OF CONCERN TO ME IN THIS PROPOSAL IS THE IDEA THAT THE BORROWING TO FINANCE THIS BAILOUT SHOULD BE OFF-BUDGET. I UNDERSTAND THE REASONS FOR IT--IT IS TO AVOID INCREASING THE DEFICIT. BUT, THE COST OF FINANCING THE BONDS OFF-BUDGET VERSUS TREASURY BORROWING CAUSES THE INTEREST COSTS ON THE BONDS TO BE HIGHER BY AT LEAST \$125 MILLION PER YEAR. THAT IS A NEEDLESS WASTE OF TAX DOLLARS AS FAR AS I AM CONCERNED.

SO, MR. BRADY, I HOPE YOU WILL SHED SOME LIGHT ON THIS PROBLEM--WE NEED ALL THE FACTS, NOT JUST PART OF THE PICTURE.

FINALLY, I AM DEEPLY CONCERNED THAT THE ECONOMIC FORECASTS USED BY THE ADMINISTRATION IN PROJECTING THE DEFICIT FOR THE NEXT FIVE YEARS ARE OVERLY OPTIMISTIC. FOR FY 1990 ALONE, IF THE CONGRESSIONAL BUDGET OFFICE IS CORRECT AND THE ADMINISTRATION IS WRONG ON REAL GNP GROWTH AND INTEREST RATES, THE DEFICIT WILL BE AS MUCH AS \$20 BILLION HIGHER THAN PREDICTED BY THE ADMINISTRATION. I UNDERSTAND THAT MACRO-ECONOMICS IS NOT A SCIENCE. EXPERTS CAN DIFFER ON THESE PROJECTIONS. BUT SUCH WIDE VARIANCES IN THE DEFICIT MAKE IT EXTREMELY DIFFICULT FOR THIS COMMITTEE TO PROCEED WITH ANY DEGREE OF CERTAINTY ON FUNDING DECISIONS FOR THE ENTIRE GOVERNMENT."

Attachment F

PROPOSED THREE YEAR ACT COST OF REFCORP BONDS THROUGH MATURITY (FY 2021)
(In billions of dollars)

	Simple Summation			Present Value in FY 89 \$ at 9.00%
	1989-94	1989-99	1989-2021	
REFCORP Bond Interest Costs				
Paid By:				
FHLB Earnings	0.9	2.4	9.0	2.6
Receivership Proceeds	10.0	12.0	12.0	8.6
Treasury funds ²	6.3	22.0	194.1	126.6
Total	17.2	36.4	115.1	37.8
Interest Premium over Treasury ³ ..	0.6	1.2	3.8	1.2

¹ Reflects interest payments over 33 years (1989-2021).

² These estimates assume no returns from warrants or other equity interests held by the RTC.

³ Assumes 25 basis point spread over comparable Treasury financing.

The CHAIRMAN. Before I proceed with any questions, I shall yield to my colleague, Senator Hatfield, for any opening statement that he may wish to make.

Senator Hatfield?

Senator HATFIELD. Thank you, Mr. Chairman. I have no opening statement at this time.

The CHAIRMAN. Does any other senator have an opening statement?

DIFFERING ESTIMATES OF S&L COSTS

Senator GARN. Mr. Chairman, if I could make a brief comment, I was just saying to Senator McClure that I just left a Banking Committee hearing on the S&L crisis to come down here to hear Secretary Brady's testimony. I thought I had left banking and I came right into the middle of the S&L crisis.

I think the Chairman knows Senator Riegle and I have conducted hearings—4 to 5 a week, 3 or 4 hours a day—on this problem for many weeks, and we do have members of the industry there this morning. So I will be returning to that hearing, but I did want to hear the Secretary's testimony.

I would only comment in response to your remarks about the estimates, Mr. Chairman, that we have had an incredibly wide variety of estimates by several agencies from GAO to OMB, and they are all different and virtually all of them have been revised upwards. I think the key to that, and Secretary Brady can speak for himself, is that people seem to think that if you actually went into every savings and loan in the country and performed an audit on the same day, if that were possible, then you could determine exactly what the loss is at the current moment.

But then, in order to predict over 25 or 30 years, you would also have to be able to predict what the interest rates were going to be month after month. So everybody's estimate comes from picking an assumption in the program. And so every estimate, it does not matter whose it is, I guarantee you, will be wrong. Alan Greenspan testified to that effect. He said, "I cannot tell you what the interest rates will be for the next 6 months, let alone for the next 30 years during the payout of these bonds."

So the point that Senator Riegle and I have tried very very hard to make over and over again, is that the size of the problem is not the issue. If you take the smallest estimate and the most optimistic, it is still an incredibly horrendous problem. What we need to do is pass a solution as rapidly as we can, because the sooner we pass it and start closing those insolvent institutions, whatever the estimate is, the cost will be lower.

Senator Riegle and I are committed to having a bill out of the Senate in April because the hemorrhage must be stopped. And I would hope my colleagues on the Appropriations Committee would understand how much time the Senate Banking Committee is putting into this. The size of the estimate is not nearly as important as getting the plan into effect just as rapidly as we possibly can.

I thank the chairman for this indulgence, and I will return to the S&L crisis in the Banking Committee.

STATE-BY-STATE S&L SITUATION

Senator ADAMS. Mr. Chairman, I did have a short opening statement, but it will be very brief.

The CHAIRMAN. Very well, let me thank Senator Garn for his opening statement, and I am sure that the expertise that he has in both the Appropriations Committee and the Banking Committee will be certainly well utilized as we approach the dealings with these problems.

Senator Adams, do you have an opening statement?

Senator ADAMS. Thank you, Mr. Chairman. Mr. Secretary, my opening statement is very brief, but it is to the point.

There are some States, and I will use mine as an example, where we have zero insolvencies, and at this point, we have zero on the trouble list. Now in 1988, a great many institutions in our State went through the problems that are being addressed by the savings and loan crisis.

What I am concerned about—and I will submit my question in writing, if it does not come around to me in time, Mr. Chairman—is that we have, and I am sure this is true of many other States, basically gone through a ringer and cleaned up most of these institutions. So the nationwide plan that goes into effect will have an impact of our people paying for it elsewhere.

I know this is true of many other States and I think it is something that we have to address in this committee and certainly in the Banking Committee.

I wanted to bring that to your attention and that is the purpose of my opening statement. I thank you, Mr. Chairman, for that and I ask your unanimous consent to revise and extend my remarks on my statement and to submit a question in writing to the Secretary.

OUTYEAR PROJECTIONS OF S&L COSTS

The CHAIRMAN. Without objection. It is so ordered.

Are there any other opening statements?

Now, Secretary Brady, in your opening remarks you stated that the net impact of the entire plan is \$1.9 billion in fiscal year 1990 and \$39.9 billion over the next 10 years. Yet the cost to the taxpayers will not end in 1999, they will run through the year 2021. What is the total cost of the Treasury between the years 1989 and 2021?

Secretary BRADY. Mr. Chairman, may I just make a statement on the general subject that you have raised this morning as to what the true cost is?

The CHAIRMAN. Certainly.

Secretary BRADY. What we have attempted to do with this plan, and there are different numbers. If you go out to years as far out as you can see, the cost goes up. We are perfectly agreeable to look at those figures. But what we have attempted to do and put before the Congress is to try to gather up the industry, the people in Congress that we have talked to, industry associations, and the administration and come forward with a plan. That plan as submitted is 325 pages of a bill and at least 10 pages of detailed figures from the OMB. We think it is the best plan, but it may not be the only plan, maybe others have a different way of looking at it.

Our feeling is that the figures that we have put forward which showed that between now and 1999 that roughly \$40 billion of what is recorded on the budget does not indicate that those are the only costs. There are costs which the industry itself pays, and if you are figuring out the total costs, those should be added to the plan.

What we say in defense of what we have put forward is that we have put forward every cost that we see attended to this plan, and compares favorably, I would say with what we do a great many times in the budget, when we purchase a new Trident submarine, we do not put all the attended costs of interest that go along with that purchase. Or with a new school lunch program, we do not say, the interest costs on that plan stretching to all these years, and so and so. They simply get buried in the budget.

I have looked up, just for the sake of the argument, the Kennedy Moon shot which was supposed to cost \$30 billion. Everybody accepts that figure as being the cost of the Moon shot, but if you add in the interest which was attended to that plan, you would have to add in another \$90 billion and say that the Moon shot really cost \$120 billion, instead of \$30 billion.

So if you go forward and add up all of the interest costs, private and public, the cost of this program goes up. And I can get you the figure over the period going to 2021, the total amount of Treasury funds that are included in the backing behind this plan are \$94.1 billion.

The CHAIRMAN. Does that mean that the Appropriations Committee would have to appropriate \$94.1 billion over that 33-year period to pay the interest on REFCORP bonds?

Secretary BRADY. That is the total amount of Treasury funds, it is my understanding it would be included over that period of time. And it obviously be appropriated over that period of time, just as interest on any project is part of the budget over that period of time.

The CHAIRMAN. So that would be the interest payment?

Secretary BRADY. Those are the total funds the Treasury will expend during that period of time.

The CHAIRMAN. That will be the interest payments, \$94.1 billion?

Secretary BRADY. That's correct, but it gives no credit for any sales of assets that we might have during that period of time, or warrants and equity participations which are a part of the plan as we go forward and are part of the \$40 billion which was already taken care of previous to January 1, 1989.

SERVICING COSTS OF S&L RESOLUTIONS

The CHAIRMAN. As you point out on page 4 of your statement, there are two parts to the problem that involve taxpayer funds. The second part is servicing the cost of the \$40 billion in resolutions already completed by FSLIC. Treasury will have to pay a substantial part of that \$40 billion, as well. Do you have the 30-year cost to the Treasury for this portion of the problem?

Secretary BRADY. Senator, I do not have it broken down. I could prepare those figures for you, but they are all in the Treasury figure of \$94.1 billion that I gave you before.

The CHAIRMAN. \$94.1 billion has to do with the \$50 billion program, does it not? That is calculated to——

Secretary BRADY. I stand corrected on that. I would have to get you those figures; I do not have them with me. I will have to submit them to you.

The CHAIRMAN. Do you have them for 10 years?

Secretary BRADY. Again, Senator, I do not have them broken out for 10 years; I could get them for you, but I don't have them with me.

The CHAIRMAN. Would it not be \$17.9 billion for 10 years?

Secretary BRADY. I cannot give you that figure exactly. Again, I can break these things out for you specifically, if you would like and I will be glad to supply that to you.

The CHAIRMAN. It would be helpful to have it for the record. I wish we could have it here.

[The information follows:]

FSLIC RESOLUTIONS

Treasury estimates that the total amount of appropriations that will be necessary over 30 years to meet Treasury's share of the old FSLIC resolutions, REFCORP interest payments, and contributions to the new SAIF fund will be \$148.7 billion.

The REFCORP interest payments over 30 years are estimated to be \$94.1 billion.

The Treasury's contributions to the old FSLIC resolution fund and to SAIF are estimated to be about \$54.6 billion from 1989-99. At the end of that time, Treasury's obligation to these two funds (as defined in the administration's proposal) will be met and the funds will be in a net receipt position as premiums collected should exceed losses.

Of the estimated \$54.6 billion, about \$37.7 billion is for the FSLIC resolution fund. Of this amount, \$18.8 billion will be used to liquidate FSLIC notes issued and scored as outlays before January 1989. The other \$18.9 billion will be appropriations for other FSLIC losses such as yield maintenance and capital loss agreements.

The estimated appropriations for SAIF will be \$16.9 billion based on estimated disbursement by SAIF of \$24.0 billion. About \$15.9 billion of these disbursements would come from thrift premiums leaving \$8.1 billion plus the \$8.8 billion mandated for the SAIF fund by year-end 1999 to be contributed by Treasury.

DIFFICULTIES IN ESTIMATING COSTS OF S&L PLAN

The CHAIRMAN. Well, to begin with I guess you would have to agree that the cost of the bailout is extremely difficult to calculate; would you not?

Secretary BRADY. Yes, sir. I would agree, it depends on what way you look at it. You can look at it as cost, if you want to take the figures which, I think, nobody has quarreled with as to how it hits the budget between now and 1999, that is about \$40 billion. If you want to include all of the interest going forward to the end of the plan, it is a lot more than that.

The CHAIRMAN. Well, should we not do that? If you are restoring public confidence, and the S&L's are fundamental to the success of the plan; is not part of that effort to restore confidence also to be completely up front with the American people as the total cost, running over the 33-year period, rather than just the cost through the first 10 years? Because in the final analysis they are going to have to pay that bill.

Secretary BRADY. It is my understanding, Senator, that all of those costs have been laid out by Director Darman. He did provide

a 30-year summary of the figures. I am sorry I do not have it with me.

The CHAIRMAN. I have his figures here on the 50-year program, but I do not believe I have them on the initial buyout which is \$40 billion. We are talking about, with respect to the \$94.1 billion over 30 years, we are talking with respect to the \$50 billion that would be used to complete the buyout, which I think would involve something like 350 savings and loans; is that accurate?

Secretary BRADY. I think that is accurate. I think the other thing that we have to keep in mind, Senator, that this is a plan that seems to have the backing of industry and it collects in 330 pages, all of the details of it, of some 10 pages of submissions by Director Darman and it lays out all of the statistics.

The CHAIRMAN. That is probably true. But what I am trying to get at here this morning, Mr. Brady, this committee needs, and the American people are entitled to have, the cost of this bailout program to the taxpayers. And as I understand it, about \$40 billion have been used to deal with something like 200 savings and loans that have gone under.

And there is the second part of the program which involves \$50 billion which would be generated by \$6 billion which up front would come from the private sector. That \$50 billion would be utilized in resolving the remaining 350 S&L's that are considered to be insolvent or probably going to be.

Now with respect to that part of the program, the interest would amount to \$94.1 billion over the 30- or 33-year period. What I am trying to get at is what is the total cost to the taxpayers. You have indicated that you are not able to indicate what the cost would be in interest payments over 30 years with regard to the first \$40 billion which have already been spent, and what I am trying to get is the total picture.

Secretary BRADY. What I said, Senator Byrd, was that I do not have those figures with me this morning. They were submitted already by Director Darman in detail going back 30 years. But you can, with regard to the amount of money that is being put up by industry, the \$50 billion of REFCORP bonds which are being financed totally off the Treasury books, that is an addition that the industry is making to the cost of this particular plan.

I would say that again, it depends on how you want to look at it. We put forward what the cost is on budget through 1999 and that is \$39.9 billion, and it is laid out year by year how much that does hit the budget. If you want to add up all the costs that the industry is putting in, that the Government puts in over a period of time, that is a much higher figure. But I would say that we are, in a sense, we are looking at this problem a lot differently than we look at other problems that the Government has to face.

S&L PROPOSAL AS OFF-BUDGET

The CHAIRMAN. Let us not look at the other problems for the moment. Let us look at this problem. And is it not, if we hope to restore the public confidence, as I have already indicated, in S&L's; is it not important that we tell the people up front what the total cost is going to be over the 30-year period, rather than just over the

10-year period. We ought to know what the total is going to be over the 30-year period. This Appropriations Committee needs to know what the total cost is. And if you are able to provide the total cost, that is what we would appreciate.

Let me go to the reference you made to off the budget and indirect borrowing, rather than direct borrowing from the Treasury. Now, I believe, you are advocating that this cost be off budget. What would be the additional cost to the taxpayers if it is off budget?

REFCORP BONDS

Secretary BRADY. Are you talking about the REFCORP bonds now?

The CHAIRMAN. Yes; what would be the additional cost?

Secretary BRADY. Well, the way we look at it, there would not be an additional cost. But I think you have to split it into two parts. It is our estimate that the REFCORP bonds will cost approximately 25 basis points more than a direct Treasury obligation. But if you take into account the fact that the industry is providing \$300 million a year toward that interest and divide that by the principal amount of \$50 billion, that is some 60 basis points. So in essence, the industry is contributing 60 basis to the cost of the REFCORP bonds which would otherwise have to be paid out of the Treasury.

And if it costs you 25 basis points extra because you financed them with REFCORP bonds as opposed to Treasury bonds, that is still within the savings that you pick up from the 60 basis points that you get from having the industry represented.

The CHAIRMAN. Well, we would still expect that the industry would pay the amount that is called for in the administration's plan, even if the borrowing is done by the Treasury.

Secretary BRADY. I do not think so, because it would be a direct Treasury obligation at that point in time. The REFCORP is an independent financing agency whose funds generated to take care of its obligations come from different sources, but in this particular point we think we save the plan money by having the savings and loan industry pick up, stand not only the cost of the principal, some \$50 billion, by buying Treasury zeros, but also due to the fact that they are contributing \$300 million a year to the payment of interest.

The CHAIRMAN. I am looking at Mr. Darman's paper, and I will not pursue this much longer. I want to turn to Senator Hatfield.

This paper indicates that the interest premium would amount to \$1.2 billion in the 10 years, 1989 to 1999, that is, at the rate of about \$125 million a year. Ten years, \$1.2 billion. Now that assumes 25 basis points spread over comparable Treasury financing. As I understand it, a basis point is one-hundredths of 1 percent. So 25 basis points would be twenty-five hundredths of 1 percent, one-fourth of 1 percent which would amount to \$125 million a year.

And then over 10 years it would amount to \$1.2 billion, and over the 30 years it would amount to \$3.8 billion. Why do we not pursue direct Treasury borrowing, put it on budget?

I think Mr. Volker testified before the Banking Committee to the effect that that would probably be the best way to go about it. That

is putting it all out on the table. And from the standpoint of Gramm-Rudman-Hollings, those figures could not be utilized because they do not come about as a result of some recurring problem. And so you save the taxpayers \$3.8 billion over a period of 30 years, \$125 million per year, and you have it all right on the face of the table.

ABSENCE OF OTHER S&L PLANS

Secretary BRADY. Well, Senator Byrd, there may be other configurations people could put this plan into. I must say I have not seen any, but I am sure there are some. But I have to go back to the point that even though the REFCORP bonds do, we estimate will cost 25 basis points more than the Treasury bonds, the way I look at it and I think it is accurate, is since we are getting \$300 million a year from the industry as a contribution to that interest payment, that is 60 basis points, so in a sense we are ahead.

The CHAIRMAN. Why not get it from the industry when you go the other way? We could do that by law, get it from the industry and put it on budget.

Secretary BRADY. Senator Byrd, I do not want to sit here and tell you that there are not other plans, I just have not seen any.

The CHAIRMAN. This is not your plan?

Secretary BRADY. This particular plan that we put forward, again, I do not want to repeat things that you know, it has got 330 pages of detail in it. It has been backed up by an enormous number of statistics out of the OMB.

There may be some other plan that works, but I would only submit to you starting where you started, which is to make sure we have the confidence of the American people that this enormous, the largest fiscal problem, I mean the largest financial problem in the history of this country, some \$90 billion is being attended to and attended to quickly, and that you gather up when you do that, all the desperate elements in this society which impinge on that plan, the savings and loan industry.

They do not like it much because I think we have pushed them as far as we can go. The commercial banking industry, they do not like it much because we have pushed them as far as they can go.

The CHAIRMAN. I do not know of anybody who likes it, but we have got to do it. And do you not think that, if we are going to restore the confidence of the American people, we ought to be right up front with everything. Go tell them what the total cost is over 30 years, not just one-third of the cost over 10 years; do you not agree with that?

Secretary BRADY. I certainly do, but I think we have been up front. We have got figures going out 30 years from Director Darman. We have 330 pages of details as to how this plan would work, including all the positive points, such as increased penalties for people who try and run their businesses in a way that they should not; reform for the industries, so I think we have done all of that. I really think it is all laid out there.

The fact, sir, that it could be done some other way, I would have to say, to be my guest. Anybody who has got a better plan, ought to put it out there. I think this is a good one and it is fair to every

part of the industry. I take your point entirely, if you go out 30 years that the costs are more, but that is true of any project the Government does.

TOTAL 30-YEAR S&L COSTS

The CHAIRMAN. That is true of any project. I do not want to belabor the point, but the American people have been told that the cost would be \$40 billion, not \$94 billion.

Secretary BRADY. Well, sir, you know the first statistics we came out with at the press conference went out 10 years because that is where we were. Since that time, we have provided statistics which go out 30 years and the figures that you put forward this morning are accurate representations of looking at it at that particular way.

I will say that if somebody wanted to come forward with the plan that said this plan that the Treasury has put forward—and I might say we have had extensive consultation with your colleagues, both in the Senate and the House—if somebody wanted to come forward with one that was completely on budget, you would then have to make some other choices which were, do you want less of this or less of that.

The CHAIRMAN. Well, that is true, Mr. Brady, and I compliment you again on coming forward with the plan. I am not critical of your efforts in that regard. I am simply saying that the American people are entitled to know what the total cost is going to be which they are going to have to pay over a 30-year period, not just over the 10-year period. And they need to know what the costs are in both parts of this program.

You, in appearing before this committee this morning, have been unable to indicate what the costs are going to be with reference to the \$40 billion that has already been spent for the buyouts that have already occurred. You have indicated that yourself. I believe, you have indicated that you are unable to say what the cost would be for 10 years.

Secretary BRADY. Of the \$40 billion cost you referred are in the figures that have been submitted. I just do not happen to have Mr. Darman's figures. I apologize for that. I can get them for you and will.

The CHAIRMAN. All right, if you would.
Senator Hatfield?

MEASURING THE NATIONAL DEBT

Senator HATFIELD. Thank you, Mr. Chairman.

Mr. Secretary, I welcome you to the Appropriations Committee this morning. I know this is your first appearance here as Secretary and it is hard to learn to address you with that different title, as one who has served in the Senate and as a treasured member of that body.

I am reminded of the 30-some years that George Aiken from Vermont served in the U.S. Senate and yet his very close staff and personal friends continue to call him "Governor," because he had been Governor of the State. I would wager that when you leave public service from your current position, you will revert back to the title of Senator.

But we are happy to have you here, regardless of how we address you. Mr. Secretary, increasingly literature——

The CHAIRMAN. On that point, the first Cabinet nomination that was turned down by the U.S. Senate was a nomination for Secretary of the Treasury. Now that is no reflection on Secretary Brady, as a matter of fact, that is a compliment, because he had no problems in being confirmed.

The first of the eight Cabinet posts was Secretary of the Treasury that was turned down. That was Roger Taney in 1834. That was when President Jackson was having his problem with the Senate over the national bank. That will not be charged against you.

Secretary BRADY. I escaped by unnoticed in September, Senator, and I am very grateful for that.

Senator HATFIELD. Roger Taney later became the Chief Justice of the United States and probably ranked as one of our top Chief Justices.

The CHAIRMAN. And who had earlier been Attorney General.

Senator HATFIELD. If he had not ruled as he did on Dred Scott, but we will not go back to that.

Senator BUMPERS. I must be in the wrong room. [Laughter.]

Senator HATFIELD. Mr. Secretary, on this matter of the severity, the implications, and the method of measuring the national deficit, we use in part the ratio of the debt to the GNP. That ratio puts us lower than France, I believe, and at about the average range of the OECD countries. If we took the net Government deficit—that is, Federal, State, and local—we would be about at the same range as Japan, West Germany, and Canada. And if we took the capital budgeting system rather than the one that we use currently which expenses all of the capital purchases in the first year, perhaps the deficit would be much smaller, at least on paper.

My question to you is, What method of measuring the national deficit do you prefer? And what do you consider the impact will be on the future of that deficit on consumer savings as it relates to foreign investments?

Secretary BRADY. Well, Senator Hatfield, you have drawn a circle right around the key statistics in my judgment. Our deficit is a percentage of GNP is the middle of the range for OECD countries, if you only include the Federal deficit. But if you add in State and local governments, it comes very near to that which that country which is given the credit for managing its affairs best now, Japan, attains itself.

However, you cannot look just at percentage of GNP because you have to pay for the deficit somewhere. You have to get funds that that deficit creates and fund them. And, therefore, we have to look at the deficit itself as a raw figure, and we have to get the funds somewhere to fund that deficit.

It is estimated to be \$100 billion this year and \$160 or \$170 billion last year. So if you cannot get those funds from our own country's savings, then you have to count on foreigners, and that is what we are doing now.

I would say if there was one thing that we all, if we could all stop for one moment and wave a magic wand over the deliberations we are having this morning, and will have for the rest of the

spring, I hope only that long over the budget, wave a magic wand and say that was gone away. Now what should we do. We should concentrate on methods by which we can get our national savings up. We simply in this country have a fly-now, pay-later mentality—myself included.

What we have got to do is develop the system whereby savings in this country become more of a national objective and I think that is very hard to do.

I have taken too long to answer your question. It is very hard to do in times of tight budget constraints, because we do not have much room to maneuver in terms of putting into the tax system those things which might be helpful to savings. I am hopeful that just in its small way, the Treasury can maybe start talking more about buying a savings bond. You know that used to be something that was a highly thought of thing in this country. And why not give, instead of some of the endless gifts we give each other, why not give somebody a savings bond? In the long run it is going to be better for them.

You got me off on a side subject, but basically we have got to figure out some way to get the savings inside this country up, or in the long, long run, we are going to be dependent on others to provide those savings for us. And I do not think that is any sounder in the long run than it is to depend on them for our security needs, in a sense it is security.

Senator HATFIELD. Are you saying that we need to look with a balanced perspective at those who, on the one hand, are giving a very light touch to the seriousness of the budget, and who are discounting the severity or the danger of the current deficit measured by these other measurements, and, on the other hand, those who are showing it as a doomsday event that has overwhelmed us? Do you mean to say that in order to look at the deficit issue correctly, we must settle somewhere in between those two particular polars?

Secretary BRADY. I do.

FOREIGN INVESTMENT IN FINANCING THE DEBT

Senator HATFIELD. And are you saying that we could not be financing our national deficit today without that foreign investment?

Secretary BRADY. That is correct. You would finance it, but you might have to pay higher interest rates, if the foreigners all of a sudden for some reason, and I do not in any sense see this. In fact, I see quite the opposite, they still think that the United States is the best place to put their money. But if for some reason they did not, then we would have to get those funds inside the United States, and presumably, we would have to bid up for them and perhaps interest rates would go up in that case.

Senator HATFIELD. Being a Pacific rim country or State, we are increasingly hearing from our constituents about restricting—particularly with regard to Japanese investments in American enterprise. Would you say that perhaps with an exception or two—such as financial institutions—would it be bad policy to try to restrict foreign investment?

Secretary BRADY. I would say a bad policy.

INTEREST RATES FOR POWER MARKETING AGENCIES

Senator HATFIELD. I have one last question for you, Mr. Secretary, and that relates to the proposal in the budget to increase the interest rates on the unrepaid balances on the power marketing agencies. You have listed that as a \$900 million asset or revenue measure. First of all let me say, I will battle you on that to the hilt; nevertheless, what I would like to ask you—I think I have someone from Idaho who feels just as strongly as I do—is how much of that \$900 million do you anticipate collecting in fiscal year 1990 if the Congress allows you that request?

Secretary BRADY. Senator Hatfield, I do not have that figure. But if I may, I will get it for you and submit it to you as an answer. [The information follows:]

ADDED PAYMENTS BY PMA'S

The budget for fiscal year 1990 includes added payments to the Treasury by all of the Power Marketing Administrations combined of \$970 million in fiscal year 1990. Such payments would result from proposed legislation to provide for straight-line amortization of Federal investment in the PMA's, with interest on unpaid balances accruing at current market interest rates.

Senator HATFIELD. I would only like to raise the point that this would have an effect of increasing the cost of power to ratepayers by some 25 to 30 percent. That would trigger immediately a process whereby Bonneville and all other power marketing agencies would have to develop some kind of rate case formula. It would trigger hearings and review of those rate increases.

That Mr. Secretary would take literally years in the courts, because the process would not end with the agency's decision or finding. I am convinced it would go to court, but in those courts, you would have appeals upon appeals.

[The information follows:]

The budget proposes a set of financial reforms designed to end the subsidies that customers of PMA's currently receive. Thus, for example, the interest rates charged on the unrepaid Federal investment would be raised to the rates that non-Federal utilities currently pay for borrowing. In addition, the PMA's would be required to repay the principal on a fixed, straight-line amortization schedule. These financial reforms are estimated to reduce the budget deficit by about \$900 million in fiscal year 1990.

Senator HATFIELD. So I would hope that you would take that into consideration when you review that request. I hope you are not counting on that \$900 million to offset expenditures in the fiscal year 1990 budget that we are hearing. I just wanted to raise that point with you. I think your people will tell you the same scenario. So in all likelihood you would not collect at least a large portion of the \$900 million as Bonneville alone is at a rate of about \$525 million.

I am sure that the other agencies would find the same kind of reaction amongst their ratepayers to pursue their rights under law in the matter of appealing those rate increases, but I think that is a moot issue. It is more academic than not, because I think we can stop that proposal. It would certainly be devastating to the economy of our State.

ADJUSTABLE INTEREST RATES

Now one other thing on that. I just want to add one subpoint. It is my understanding that the interest rate charged under this scheme would be tied to AAA utility rates of interest which are recalculated yearly. Just for the record, what is the Treasury Department's policy regarding adjustable interest rates?

Secretary BRADY. Senator Hatfield, I do not have that policy with me this morning. When I give you this figure for fiscal year 1990, I would like to provide that at the same time.

[The information follows:]

Under Federal credit policies, set forth in OMB Circular No. A-70, interest rates are to be determined taking into consideration prevailing market yields for obligations of comparable credit quality and of comparable maturity. Under this policy, the interest rate on a 50-year adjustable rate obligation whose rate was adjusted yearly, for example, would be determined based on prevailing market yields for comparable quality 1-year instruments at the time of each annual adjustment.

Senator HATFIELD. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Hatfield.

Senator Johnston?

REFCORP PROPOSITION

Senator JOHNSTON. Thank you, Mr. Chairman. Welcome, Mr. Secretary.

Mr. Secretary, I am interested in your brief REFCORP proposition. As I understand it, from the various private sources from the industry, you are getting what I assume to be the maximum practical amount from them which is the equivalent of 60 basis points of interest; is that right?

Secretary BRADY. That is correct.

Senator JOHNSTON. And the disadvantage is by using private financing, you are paying about 25 additional basis points, rather than having direct Government borrowing; is that correct?

Secretary BRADY. That is correct.

Senator JOHNSTON. Now if you put the full faith and credit of the Federal Government behind REFCORP bonds, you could save the 25 basis points; could you not?

Secretary BRADY. You could.

Senator JOHNSTON. Now are we not, in fact, really liable anyway since everyone knows we cannot walk away from FSLIC guarantees and from all of the industry obligations; so are we not really paying out 25 basis points in order to keep this borrowing off budget?

Secretary BRADY. Whether you would or would not walk away from these bonds is the measure of that is 25 basis points, so somebody thinks that in order to buy these bonds, as opposed to straight Government obligations, they wanted another one-quarter of 1 percent. So I am not sure that everybody would agree that you would not walk away, otherwise you have the right to walk away. Whether you do or not, obviously is something for each individual investor to look at. My assumption is the same as yours, we would not. But by the same token that is what the 25 basis points really amounts to.

Senator JOHNSTON. My point is, I think, we do not need to pay that 25 percent because we never would walk away.

Secretary BRADY. But again, Senator Johnston, this whole plan is complicated I will grant. And you can look at it in terms of its financing anyway.

Senator JOHNSTON. It is multivaried complication and just add one element, "full faith and credit," and you save—

Secretary BRADY. But in this particular part of the plan, you would lose the 60 basis points that the industry is contributing.

Senator JOHNSTON. No, you would keep the money coming in from industry, just add to it "full faith and credit."

Secretary BRADY. Well, sure. Again, I get back to the basic premise which is, this is a plan we think works. We have collected a lot of different people's inputs into the thing. It hits the budget in a certain way. If you do not want to hit it in that particular way, then—

FISCAL YEAR 1990 BUDGET PROPOSALS

Senator JOHNSTON. Which brings me to my main point which is this, there are six ways that I have figured out to meet Gramm-Rudman: real cuts in the budget, taxes, economic assumptions, technical readjustments, unrealistic proposed budget cuts, and changed targets. Now it seems to me what this administration is proposing is first of all big economic assumptions. A lot of technical, and this is in the neighborhood of a technical because you are putting this off budget, paying 25 basic points for it, but it does not come on budget, so therefore it is a technical readjustment.

There are a whole lot of unrealistic hopes. In this budget, I think, they abolished the Appalachian Regional Commission and I know my chairman thinks—

Secretary BRADY. They have done that for 8 years.

Senator JOHNSTON. I know that is unrealistic. I know \$2 billion out of Alaska for drilling is unrealistic and on down the road. It seems to me that this is the year when we need to face up to what are we going to do about the budget. Next year is election year. I think the basic strategy of the administration is, "Look let us get by this year, nobody wants taxes this year, we will have to do it next year, put it off till next year." I think since you were here as a Senator, we have been putting this off till next year.

And I know we did that last year. We did it as part of the budget summit. I think we really have to face up to making whatever real budget cuts we can and those are very limited. You can say we are going to do all of these grand and glorious things, but they are not going to get done. You are not going to get \$5 billion out of Medicare. We tried to get \$2 billion, as I recall, out of our economic summit and it seems to me we ended up with about half a billion, and that was painful. Because that comes out of country hospitals and all that.

I mean, I know what all the arguments are on these economic assumptions, you can argue all day long about how OMB has been closer and better than CBO, but you are not going to convince me and probably not yourself that interest rates are going to be 5.5 percent next year. I just think we need to come together in realis-

tic budgeting in fiscal year 1990, the first of 4 years for this President, a nonelection year, and face up to these things and do them. And I think we are going to have to end up changing the targets.

Because I do not really think, even if you are willing to do taxes, I do not think you can put in enough taxes and real budget cuts with real economic assumptions to meet that 110 target. But we ought to try. We ought to try and meet it and if we cannot, realistically change it, rather than putting it off until next year.

GRAMM-RUDMAN-HOLLINGS TARGETS

Secretary BRADY. Without arguing, all of the six things that you mentioned, I would caution particularly on one that I feel very strongly about, Senator Johnston, which is talking about moving the Gramm-Rudman targets is just exactly what the people and European investors think we are going to do.

Senator JOHNSTON. Well, I read that in your statement, but your budget does it, but says you do not. I mean it does it by saying interest rates are going to be 5.5 percent.

Secretary BRADY. I do not know whether they reach 5.5 percent next year, but I tried to make the point, and I guess statistics can be melted any way you want. In the back of my testimony I have one chart which in my simple mind makes a big difference. It shows the 3½ months on either side of when you pass Gramm-Rudman, and from 3½ months prior to the time you pass Gramm-Rudman, till 3½ months after you pass Gramm-Rudman, interest rates came down 300 basis points.

Now the Fed was helping at that particular point in time, but they were helping, in my opinion, because they thought that we collected ourselves, not in a perfect way, but in a way that we could all get together on it, and Gramm-Rudman had tried to do something about it.

So I take everybody's point on the fact that Gramm-Rudman is not perfect and the ways you can change it, but it is a form of sanity and I think before we start talking about changing that, because the rest of the world thinks we did something in Gramm-Rudman, not perfect, but tried to collect ourselves. So I feel very strongly that we should not move the goal line.

Senator JOHNSTON. Well, I know, but you have not proposed any realistic way to get to the goal line.

Secretary BRADY. Well, Senator Johnston, we are in the middle of budget negotiations now and put forward, it is not for me to get into a budget discussion here. But there is a plan out there, it is not perfect. It has got some holes in it, but to my—

Senator JOHNSTON. It is not even the beginning, that is the problem.

Secretary BRADY. I think it is a beginning.

Senator JOHNSTON. Look, I want to help this administration. I want to help this President, because it is our country, you know. We just do not have the beginning place, I mean, that is the problem. What we need to do is find an adequate beginning place where rather than have all of these fictitious dollars out there, dollars of cuts, I mean these are not real cuts in the budget. They are phantom dollars. You know that. Every often in a whim somewhere and

you tried to defend 5.5 percent, we would have a good laugh and——

Secretary BRADY. Again, I do not know if 5.5 percent is the figure for this next year, but what I do defend is the fact that the interest rate can change and did. In 6 months 300 basis points the last time that this Government came to closure on a form whereby you could get budget deficits down. It is not perfect, but I take a more optimistic view that we should not abandon a good plan in search of a perfect one, because I do not think we will ever get there.

BUDGET NEGOTIATIONS

Senator JOHNSTON. Well really my purpose is not to argue with you, although I guess I have done that, but my purpose is to plant the seed to appeal to that deep fairness which I know you have and a commitment so that you will think about how we get a start on a real negotiation. I agree we have got to have a real negotiation, but we have got to have a starting point, and right now we do not have a starting point.

Secretary BRADY. Senator, you have heard a lot of the rhetoric on this, and I will only repeat a part of it, which is there is a plan up there which has got, I believe, it is the furthest ahead that any President has been in a number of years in terms of a budget. There is some 1,396 pages, and I hope Senator Byrd does not ask me any statistics about them, because there are so many I cannot follow them. But I respectfully disagree, I think we do have a starting place, and I have optimism that we are going to reach the goal line without moving it.

Senator JOHNSTON. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Johnston.

Senator McClure?

Senator McCLURE. Thank you very much, Mr. Chairman. I would be happy to yield to Senator Hatfield for a moment.

Senator HATFIELD. Mr. Chairman, I would ask, because there are some questions that I would have that I would like to be submitted for the record. And also on behalf of Senator Kasten, these are some questions that he would like to have on the record.

The CHAIRMAN. The questions will be submitted for the record. Senator McClure?

BONNEVILLE POWER AGREEMENT

Senator McCLURE. Thank you very much, Mr. Chairman. I want to pursue three different lines. One is to pursue what Senator Johnston has just initiated. I will return to that a little later, I want to get back to a couple of others and perhaps in the order. They are inverse order of their importance to the Nation. One is what Senator Hatfield's remark in respect to Bonneville power repayment schedule.

You have dealt in the market for a lot of years and your reputation and dealing in that market is impeccable. We have looked at your qualifications and approved them in giving our advice and consent to your selection as Secretary of the Department of the Treasury. I think part of the reason your reputation is what it is, is that your word is good and it always has been good. I suspect if you

were to sell a security on the market, you would expect that the security would comply with the terms of that security during its life; would you not? If it said it has an interest rate specified on the face of that security, you would expect that interest rate to be paid during the life of the security; would not you?

Secretary BRADY. Yes.

Senator McCLURE. If the Department of the Treasury issues a bond with a fixed interest rate on it, you do not expect that the Government is at some point when interest rates have declined are going to arbitrarily and without renegotiation of that contract, simply change the interest rate to a lower rate because the Government has the authority to do so; would you? You would expect the Government would keep its bargain?

Secretary BRADY. [Nodding affirmatively.]

Senator McCLURE. You nod your head?

Secretary BRADY. I am agreeing with you.

Senator McCLURE. OK, I want that to show on the record.

Secretary BRADY. Absolutely; I am on the record.

Senator McCLURE. So the point is obvious that the Federal Government made a bargain with certain people that are not, in certain areas of this country, depended upon the bargain that was made. There was a bargain made when the Bonneville Power administration facilities were constructed by the Federal Government. They were upon certain conditions then stated in that project cost, and those were merged later into the Bonneville Power repayment schedule to pay them back according to the terms negotiated at the time the projects were constructed.

Do you not think it is equally important for the Federal Government to keep its bargain and live with the bargain that was made, even though we now say, "Well, gee, we should have done better"?

Secretary BRADY. Senator, I cannot—you know, your logic is very compelling and I agree with it. What I would like to do is have the opportunity to review this and get back to you. I do not have the details before me this morning, but what you have said I certainly agree with.

Senator McCLURE. And that is where many of us come from is simply the fact that you cannot arbitrarily change the economic terms of a bargain made upon which people have relied and many of the investments throughout the Northwest have been made on the basis of the bargain that was made. And the people in the private sector looking at those projects and they expect the cost of energy, have made investments based upon that fixed base.

For the Government now to come in and try to change it seems to me to be grossly unfair and something that obviously many of us will not support.

TAXPAYER INVOLVEMENT AND FSLIC

The second question that I would like to get into very very briefly is FSLIC. And I am not going to belabor that subject, but for my own information, how do you view the Federal taxpayer involvement here; does that involvement guarantee, does it protect depositors, the officers or the shareholders of the savings and loan industry? Where do the benefits flow?

Secretary BRADY. Could you say that question, I want to make sure I answer it——

Senator McCLURE. Do the benefits of the Federal taxpayers expenditures flow to the officers of the savings and loan associations, to the shareholders of the savings and loan associations, to the depositors of the savings and loan associations——

Secretary BRADY. I understand now, Senator McClure. Well, the benefits in my opinion flow to the depositors. We are putting forward a system here where the S&L industry in the future looks to be mighty good. The people in this plan, I think, there has been an enormous amount of nervousness among depositors in the last year about whether the Federal guarantee really was there, was not there, whether it was there for the whole \$100,000 or was not.

So I think the plan will resolve this problem, and you will have a healthy S&L industry, not tomorrow morning, but in the ensuing years. And that it will lay to rest for the future, I hope, any suggestion that the deposits that people make in savings and loans are not good.

The fact that these interest rates have risen in the last year or so on deposits is a result of the fact that people worry about whether they are going to get paid or not. And I think we ought to remove that.

OFFICERS IN FSLIC INSTITUTIONS

Senator McCLURE. In the package that you have presented, the total package, without separating it into constituent parts, does the package guarantee to a fraudulent officer, an officer who has acted in a fraudulent manner, that he will end up with any more money in his pocket because of the transaction?

Secretary BRADY. Certainly not, in my opinion. In fact, the change in penalties which are extensive in this 330-page bill we have put forward, gives the Government a great many more powers in going out and getting the officers that have been fraudulent and doing something about it. I think the penalties are increased in certain instances to \$1 million a day.

Senator McCLURE. If we look at officers of savings and loan associations who have not been fraudulent but who have exercised judgment that in retrospect has proven to be bad judgment, just bad judgment not bad faith; are those officers in any way enriched?

Secretary BRADY. I do not think so because if they have been exercising bad judgment, I presume they are now insolvent. And a great many of those institutions will be resolved, taken over by REFCORP. Presumably if these fellows have been doing bad jobs, they will be removed from their job and they will not be there.

Senator McCLURE. Are there any shareholders of savings and loan institutions that will benefit from this takeover if, as a matter of fact, they have been badly or fraudulently——

Secretary BRADY. I do not think in the sense that you are asking, they are going to be bailed out. The answer is no, they will not benefit from it. If you are talking about a healthy savings and loan industry and that being a benefit in the future, then, of course, there is a benefit there.

Senator McCLURE. Would be to them, but not to their particular institution at this particular time?

Secretary BRADY. That is correct.

Senator McCLURE. So if there are any benefits that flow as a result of the taxpayers involvement, any direct benefits, would be to the depositors of these troubled institutions?

Secretary BRADY. That is right again, if you are talking about dollar flows, but I think you have to take into account the fact that it is our estimate that if this plan goes through more or less in the form that it is in, that the industry itself will have to pay less for its deposits. And that should be a benefit, in the long run, to the mortgage people who will go into these institutions to try and get mortgages.

Senator McCLURE. That is a future benefit rather than a direct flow of taxpayers dollars into the pockets——

Secretary BRADY. That is just the total operation of the free market.

COST OF THE NATIONAL DEBT

Senator McCLURE. Finally, I just want to in a very brief manner address the budgetary question, because I think there is a basic political question that has to be answered in here somewhere, and I think, we need to get it out in front of the American public.

The chairman was pressing you very hard to get before the American public the entire cost of the savings and loan package that you now have over time. It is equally important, I think, that the public have some idea of the cost of the national debt over time. It is equally important that we be up front with them on what we are doing to their future. Do you recall offhand the total personal income tax collections last year?

Secretary BRADY. I do not, Senator McClure, not off the top of my head.

Senator McCLURE. I wonder if any of your staff behind you can supply that number? I will not hold you, give or take \$10 billion, you know, that is not much around here.

Secretary BRADY. Why do we not look for it. I do not know if we have it in our papers right here this morning.

Senator McCLURE. What was the interest on the national debt last year?

Secretary BRADY. I have a figure here of \$154.7 billion in 1990, or 13 percent of the total budget outlays.

Senator McCLURE. That is the interest on the national debt?

Secretary BRADY. Net interest paid, so I cannot tell you what it is net of, but maybe that is a big enough figure to make the point.

Senator McCLURE. That is close enough. What personal income tax is collected last year from all sources, roughly twice that?

Secretary BRADY. Cannot answer you right off the top of my head, Senator.

Senator McCLURE. If you would supply it for the record, that would be good enough.

[The information follows:]

Gross individual income tax receipts totaled \$473.7 billion in fiscal year 1988.

Senator McCLURE. My point in asking this question is my recollection is that the interest on the national debt consumes about one-half of all of the personal income tax that was paid. Which is another way of saying to every taxpayer, regardless of their age, if they are 95 years old and still paying taxes, or if they are 19 years old and just starting to pay taxes, that their expectation can be that under current conditions for all of the rest of their life, one-half of all the personal income taxes they pay will be paid for the consumption that we have consumed in our lifetimes, yours and mine.

Secretary BRADY. [Nodding affirmatively.]

Senator McCLURE. If we want to look at total cost of a Federal program, the total cost of running these debts is staggering. That is why I respond a little bit to my friend Senator Johnston when he says that the budget figures are not even a starting point. They have to be a starting point, but indeed if the Congress of the United States either can control its spending or it cannot.

If we confess that we cannot, the American public ought to know that, and I suspect if we can confess that we cannot control spending, they are going to look for a collection of men and women who will make a pledge that they can control spending. There are those who do not want to control spending, that is different.

Senator JOHNSTON. Would the Senator yield?

Senator McCLURE. Yes.

BALANCING THE BUDGET

Senator JOHNSTON. I think it was President Reagan who said, "If you cannot balance the budget, Jimmy Carter, move over, I can."

Senator McCLURE. He tried mightily, and a collection of men and women in the Congress of the United States frustrated him. Whether you liked his budgets or not, whether we accepted them or not, the Congress set the budgets. The President did not.

No President of the United States ever spent one penny the Congress did not first appropriate. You cannot pass the buck.

Senator BUMPERS. We are lucky, because we appropriated over the 8-year period about \$30 million less than he requested.

Senator McCLURE. That may well be true, but every penny that was spent was appropriated by the Congress, every penny of it. As a matter of fact, there was a big fight back when President Nixon was in office because President Nixon tried to spend less than Congress appropriated, and we responded with the Empowerment Control Act to force the President to spend every dime we had appropriated, and I participated in some of that.

All I am trying to say is, you cannot pass the buck, it stops here. This is the Appropriations Committee and we only control about 15 percent of the total. About 15 percent of the total budget, and the rest of it is in interests, plus the defense budget. If you take defense and interest out, there is only about 15 percent of the rest this committee has anything to say about, a little less than that.

The result, of course, is what is fact, and that Congress is responsible for the shape of the expenditure, and Congress has to respond to the challenge.

If indeed this budget that has been presented to us is unrealistic, then I think the Congress either says, "OK, what is realistic," or says, "We do not have the capacity to do that." And the American public are entitled to judge us on that basis.

The CHAIRMAN. Senator, your time is up.

Senator McCLURE. Could I ask one final question?

The CHAIRMAN. Without objection.

INTEREST RATES UNDER GRAMM-RUDMAN-HOLLINGS

Senator McCLURE. Mr. Secretary, if we succeed in meeting the Gramm-Rudman-Hollings target of \$100 billion deficit last year, is it your considered opinion that the interest rates will be as presented in the budget?

Secretary BRADY. Certainly, Senator McClure, I stand by the chart which I put at the back of this testimony, and will show the 300-point decrease around the time the Gramm-Rudman was enacted. I believe there will be a substantial decrease, should we reach this. If we reach the \$100 billion figure, I think the interest rate assumptions and the budget will be very very nearly accurate.

Senator McCLURE. And if we do not, then the rates will be higher?

Secretary BRADY. Who knows?

Senator McCLURE. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator McClure.

Mr. Sasser?

WAIVING GRAMM-RUDMAN-HOLLINGS TARGETS

Senator SASSER. Thank you, Mr. Chairman.

Mr. Secretary, I will be brief, and Mr. Chairman, I will try to give back some of my time here. Some of our colleagues have been sitting here for some time.

Mr. Secretary, I have had the opportunity and the pleasure of participating in your appearance before both the Budget Committee and the Banking Committees, so I have asked most of the questions that I wanted to ask.

I will say this, that the FSLIC rescue proposal which the administration has advanced, there are some problems in it. I have quarrelled with you over the economic assumptions, have differed with you over the question of growth of deposits in S&L's. The plan projects growth and deposits for S&L's that outruns the growth and deposits for commercial banks, and frankly, I do not think that is going to happen.

But on balance, I have commended the administration for at least coming forward with a program and trying to stop this hemorrhage that is costing us, according to my calculations about \$1 billion a month and from keeping these brain dead S&L's in operation. Now, I think I hit a responsive cord there.

Mr. Secretary, there is some thought up in the Banking Committee that we would be better off if we waive the Gramm-Rudman-Hollings targets and simply put the FSLIC rescue on budget. And the argument is that that would save \$125 million a year by putting it on budget, and over a 10-year period over \$1 billion. What, in your judgment, would be the reaction of the markets, or would

there be a reaction, one way or the other, if we waived the Gramm-Rudman-Hollings targets and put the FSLIC rescue package on budget?

Secretary BRADY. Skipping the FSLIC part of it, Senator Sasser, the colloquial I had with Senator Johnston, I just would not do that. I think the foreign markets and people who vote with their pocketbook, in a certain sense, it is unfortunate because they vote silently, and as I mentioned to you in my introductory remarks here, every night that the Federal Reserve, I do not mean to be prophetizer, but you know, if you spend 35 years in business you get to look at certain things that mean things to you.

Every night at the Federal Reserve \$1 trillion worth of transactions settle. Now that and of itself is not the all important point, it depends on what price with this settles. So if the farmers lose confidence in us and want to settle those transactions and are not willing to pay the prices that they are now willing to pay, it is going to be very important to this country, and it is not going to be helpful.

So I just have to come down flatly. This just does not get into the middle of the budget discussions, I do not think. But I would not move the Gramm-Rudman targets, and all I can say to you is I have said this same thing to the President of the United States above as forcefully as I have just said it this morning.

Not that he was thinking of moving them, but because he said certain things in the press and what did it mean. I told him, I said it is a bad thing to be talking about, not to be considering but I would not move it. I think the farmers are just sitting there watching us. They understand in detail our budget transactions.

Senator SASSER. We are going to have to have the acquiescence of the President of the United States to move the targets. So if the President is not going to acquiesce in moving the Gramm-Rudman-Hollings targets, and I am not making the judgment about whether or not the President is correct or incorrect in that posture, but if he is not going to acquiesce in moving the Gramm-Rudman-Hollings targets, then the whole argument becomes a dead issue.

In other words, we are losing \$1 billion a month with the S&L's. It appears to me we better move forward and do something rather than trying to get the President to agree with us or agree with some of our colleagues here to waive the Gramm-Rudman-Hollings targets and let us put it on budget, so we can save \$125 million a year in interest rate costs, and \$125 million a year over 10 years is not an insignificant amount of money. But that would buy a lot of hot lunches in schools and build a lot of roads in Appalachia where we need to build them and do a lot of other things.

But when you lay that down against losing \$1 billion a month in this S&L problem, it appears to me that we may be spinning our wheels in trying and hoping the President will agree with us on moving the Gramm-Rudman-Hollings targets and delaying on getting the physic rescue package through here.

Secretary BRADY. The \$1 billion a month figure, I think, is an accurate figure, Senator Sasser, for earlier on in 1988, but as the unprofitable S&L's get resolved, so-called, that figure has continued to come down and I think you will see it in a much lower rate very quickly. At any rate, in the package that we presented to Congress, estimates for that monthly loss are included, so whatever those

costs are, they are included in our submission to Congress that are in those figures which we have provided.

FED CLEARING ACCOUNTS

Senator SASSER. One final question, Mr. Chairman. Mr. Secretary, in this \$1 trillion worth of accounts that have to clear every evening at the Fed, in the event the accounts do not balance, in the event foreigners do not come in, what do we do to make them balance, raise interest rates to attract additional foreign funding?

Secretary BRADY. I did not hear the gist of the last part of your—

Senator SASSER. Well, you were talking earlier about the \$1 trillion worth of accounts, that they have got to clear and balance every evening or every 24 hours at the Federal Reserve bank. What happens one evening if the accounts do not balance, if there is not enough foreign funds coming through there to balance off the—

Secretary BRADY. Senator Sasser, I think they always balance. It is the question of what price.

Senator SASSER. That is my point. In other words to make them balance, you are going to have to raise—you may have to raise interest rates to attract foreign capital; right?

Secretary BRADY. That is certainly one of the things that could be done, yes, and would have to be done.

Senator SASSER. So if we raise those interest rates, of course, that is transmitted back through into domestic interest rates?

IMPORTANCE OF GRAMM-RUDMAN-HOLLINGS TARGETS

Secretary BRADY. That is exactly correct. I think you and I are headed toward the same point. And I think it applies not—

Senator SASSER. The point I am trying to make is whether we here in the Congress think there is much to Gramm-Rudman-Hollings or not and sometimes I think there is not much to it, apparently there are some people out there in the financial markets who are not as quite as smart as I thought they were. I mean, they seem to think there is something to these Gramm-Rudman-Hollings targets. And if we start fooling with them, then we may start getting ourselves into trouble.

That is really the question I am asking you, and I think that is the message I am hearing back from you.

Secretary BRADY. My message is, if you will permit me, twofold. One, they do think it is important, and two, with respect not only to the savings and loan package, but to the budget it has a bearing.

The longer we take to get these things done, the more people start are you going to get them done. It is only human nature; it is not something that is inordinately complex. So from my perspective it may be one that is short-sighted, but having come from the financial markets, they understand what we are doing now. They understand there is a give and take. They understand that we are not a parliamentary form of government, and because the Prime Minister says, go this way, everybody follows that. They realize we have a difference in how we operate.

But there is some limit to the amount of time that we should take. It is not this morning, and I am not saying it is next week, but I think that the longer we take to settle some of these problems we have outstanding, the more risk we are taking at having those transactions that settle through the Fed, settle at prices which are unfavorable to this country.

MARKET REACTION TO DEFICIT

Senator SASSER. This is my last question, Mr. Chairman. I apologize. The budget deficit for fiscal year 1989 is going to be somewhere in the neighborhood of \$170 billion, as I understand it, give or take a few billion on either side. Now the administration is projecting that their current policy deficit will be \$127 billion. I mean, taking the administration's economic assumptions, and if we did nothing, we would have \$127 billion deficit for fiscal year 1990. The Congressional Budget Office takes what I perceive to be more a realistic approach, and they indicate that their current policy deficit for fiscal year 1990 is going to be about \$146 billion.

That means if we do nothing and just let the Government run on automatic pilot, we would have a deficit of \$146 billion for fiscal year 1990.

Now the administration is coming to the Congress and they are asking for deficit reduction in the neighborhood of \$27 billion in hard numbers or relatively hard numbers from \$127 billion down to I think \$99.6 or \$99.8 billion. And I agree with Senator Johnston, I think some of those savings are loose read and we are going to have a very difficult time making them. Some of the savings fall into smoke and—categories to get it down to the \$99.6 billion.

But this is my point, if we have got \$170 billion deficit in fiscal year 1989, and we end up with a deficit of say, \$150 or \$145 billion in fiscal year 1990, when all the dust settles, all the economic assumptions had been pushed aside, and in the cold light of day, in reality at the end of the day in 1990, if we have got a budget deficit of \$145 or \$150 billion, which I think may very well be the case, we still had \$20 billion worth of deficit reduction from 1989, from 1990 over 1989. You see down to \$170 to \$150 billion.

How are the markets going to react to that? What is your sense of it? Dr. Greenspan the other day, I thought he was telling us that as long as you got the \$20 billion worth of deficit reduction, and it was coming down, that was enough.

Secretary BRADY. I am not familiar in detail, Senator Sasser, with what Chairman Greenspan said. I think he did say though that with regard to the interest rate assumptions that if we did meet the target, that he thought interest rate assumptions would be all right. I still believe that we ought to aim at the \$100 billion target, and I cannot give you an estimate as to how much different it would be if it wound up at \$120 billion. I have just had my sort of blinkers on trying to figure out how we get to a hundred.

[The information follows:]

I welcome one major aspect of the implicit framework you utilize in asking your question—that, as President Bush has proposed, we build the fiscal year 1990 budget from the outcome we anticipate for fiscal year 1989.

I believe financial markets anticipate that the adopted fiscal year 1990 budget will achieve substantial deficit reductions from the fiscal year 1989 level within the Gramm-Rudman-Hollings framework.

If we—the administration and the Congress—negotiate a budget agreement that achieves real deficit reduction and meets the GRH target for fiscal year 1990, I would hope that the financial markets would look upon this favorably as making meaningful progress toward eliminating the deficit.

It is, I believe, too early to speculate on how markets will react if we are unsuccessful in achieving the GRH target. I believe the target can be reached and that our efforts should be focused on that goal.

Senator SASSER. Let me just make this comment. I think the markets have already discounted the fact that we are not going to get to a \$100 billion, although I am going to try very hard and I think they are looking in terms of \$145 to \$150 billion deficit next year, and that is what we have got to get to. If we do not get to it in realistic terms, that is when we have got problems.

The CHAIRMAN. Senator Bumpers?

GROWTH RATE PROJECTIONS

Senator BUMPERS. Thank you, Mr. Chairman.

Mr. Secretary, I know I am going to be covering some ground that has already been covered, but I must say I wish we had a truth in budgeting bill. It is very difficult for us and people like Senator Sasser, who chairs the Budget Committee, to be realistic about the President's request that we reason together. When we look at figures that are so grossly out of line.

If I had not been a Governor one time and used to putting numbers down just to make the budget balance, I might not be as cynical as I am about it, but I admit that we used to do that too.

Here we have the administration projecting for this year 1989, a 3.5 percent. Both the Reagan and Bush budgets in January projected a 3.5-percent growth rate in 1989 and yet the current figures for the last quarter of 1988 were 2 percent. I saw automobile were down for the last part of February by 14 percent. The real estate people tell me that things have gone kerflunk since the discount rate went up, and interest rates are going up. Maybe long-term interest rates are not as high as short-term, but we have a projection of 3.4-percent growth rate in 1990.

You have Alan Greenspan on the other side saying that if we have that kind of a growth rate, he is going to continue to raise interest rates. And every time he raises them a point you can add \$10 to \$12 billion to the deficit.

Do you consider those growth rate projections realistic?

Secretary BRADY. Senator, I really do. I think that again, I am not spending my time staring at statistics, but I think the growth rate that we have projected actually is slightly lower than that, when you adjust it for the drought last year, it is in the area of 2.8 percent. But I would only say that this is a game that is hard to be right on. The administration has underestimated it, four times in the last 7 years overestimated it, and I think the figure I gave in my testimony was that the average figure is 3.3 percent over 40 years.

Senator BUMPERS. You see, I think we are just headed for a train wreck and I am in pretty good company with people like Henry Kaufman who says we are headed for a train wreck. I think he has

predicted maybe eight of the last five recessions, but I do not think anybody can doubt that when you look at the figures, he certainly has the numbers on his side, if not history.

But here, just to continue with these assumptions on the budget, the Reagan and Bush budgets both projected a 6.3-percent interest rate for year 1989. As of last Friday, it was 8.63 percent and there again for every point we miss it, the budget deficit is going to be \$10 billion higher this year. I think CBO is now suggesting that the budget deficit for this year will not be \$127 billion. It is going to be \$140 billion.

I do not know what we say, I thought Senator Sasser asked you a question in one hearing and I read something about where you said, one of these days you are going to have a T bill auction down there, and if the Japanese do not show up, what are we going to do.

You are projecting a 5.5-percent interest rate for 1990.

It is very difficult for me to believe that people are really being sincere when I look at figures like that. I asked Mr. Darman all these questions here last week, and he is a very engaging gentleman. He is certainly a lot more pleasant to deal with than David Stockman or James Miller were.

But the figures you're using are just as gross. You have projections of an inflation rate of 3.8 percent for 1989, and in the first 6 months it is already 4.8 percent. You have got a project of a 3.7-percent inflation rate for next year.

And the gross interest cost—I know the budget only covers net interest rate—but the gross interest rates we are going to pay out this year is \$248 billion, not \$154 or \$164 or whatever the net interest figure was. We are actually paying out \$248 billion to finance the debt.

We are reaching the point where we print \$700 million a day in money we do not have just to keep the Government afloat on that day's interest. It is an unbelievable thing. As Senator Johnston said, we are not going to cut Medicare \$5.5 billion. Eighty rural hospitals in my State are just hanging by their thumbs.

I asked Mr. Darman how would you feel about people like Senator Bumpers who will have \$125,000 or \$150,000 this coming year, instead of just paying that 7-percent interest on social security on the first \$49,000 of my income, I am going to pay 7 percent on that, 1.5 percent of that goes into the Medicare fund. Why not say to people like me, you will pay that 1.5-percent Medicare portion of that on all your income, including income in excess of \$49,000.

Secretary BRADY. Senator, we are unalterably opposed to that. You cannot only finance amounts against Medicare, you could finance Medicare and get about a \$4 billion deficit reduction out of that. And why should not people in my category help take care of those who cannot take care of themselves.

CAPITAL GAINS RATE

Senator BUMPERS. Let me ask you a specific question on the capital gains. You are projecting that your new capital gains rate will go into effect on June 30 of this year or July 1, 1989, and that budget impact for this year would be a revenue gain of \$700 million, and for 1990, you projected a revenue gain of \$4.8 billion.

That is, in other words, the Treasury would receive a net revenue benefit of \$4.8 billion in 1990 if we enact your capital gains rate.

Now that has to assume that enough people will sell their stock and pay 15 percent, way in excess of those who would otherwise sell their stock and pay the current 28 or 33 percent rates. In other words, if I sell a stock in 1990 with no capital gains rate, I am going to pay a 28- or 33-percent tax on it. If you have your way, I am only going to pay 15 percent. So you are going to lose a lot of money with the 15-percent rate because I am probably going to sell it anyway. You are just simply going to give me a huge windfall.

I think your projection of a revenue gain is correct. I think you will get at least \$5 billion in net income next year. Because your bill, if it ever passes, is retroactive.

Now why should a guy with a million dollar portfolio right now who made his investment on the assumption that he was going to pay a tax of 28 to 33 percent, why should we pass a gains tax here that cuts his tax rate? He did not make investment on the assumption that he'd pay a 15-percent tax. He made it on the assumption he was going to pay a minimum of 28 percent, up to 33 percent.

Now if you want to reward people for making investments, why not make the gains incentive prospective and not retroactive? Why should we give that guy a multibillion windfall?

Secretary BRADY. Well, Senator Bumpers, first of all, that presumes he bought it last year. I do not know when he bought it.

Senator BUMPERS. It does not make any difference. If he bought it—

Secretary BRADY. But he may have bought it back when there was no capital gains taxes. So it depends, these things have changed over the years. Let me get to your point. I do not believe the retroactive part of this is very expensive from the revenue point of view. And what we are trying to do is to make sure that people do invest for the long term in the future.

So it was all part of a study that we did at the Treasury which is aimed at trying to increase people's incentives to invest in long-term gain, invest for the long term. If they invest for the long term maybe the people who run companies who invest for the long term will do better and we will stop this incredible preoccupation with what happens tomorrow. And to me it is a guy that is in capital gains right now, his horizon is only 5 minutes, if the thing goes up. If his stock price goes up 10 points, he pays no penalty. So to me it makes a lot of sense to try and get these people to invest with the long-term view.

In a sense, sure we are wanting him to do that, but it is the fact that if we collect more taxes means that they are paying taxes. These are people that are sitting there now and may never pay it. So from the Government's point of view, it is the so-called rich who will pay these taxes. So it depends on what angle you look at it.

JOINT TAX STUDY ON CAPITAL GAINS

Senator BUMPERS. Have you looked at the joint tax study of this? Secretary BRADY. I have.

Senator BUMPERS. We would lose a double ton of money over a 3-year period.

Secretary BRADY. Senator, you have been watching the difference in Treasury estimates from joint tax estimates for a lot longer than I have. All I can tell you is, I never met any of these guys. I did not try and change their mind. We put forth some assumptions which attempt to stretch forth people's horizons. We also tried in a very minor way to help those people with income under \$20,000. I know you can say, well that does not matter; they do not have much money, but they own houses.

And somehow, actually the joint tax estimators on that particular item came up with a bigger figure than did the Treasury operators. So it would not be useful for me to get into the difference between these two things. There have been differences forever as far as I can see. I do not know, maybe we ought to go back and go run a long-term study of who has been right. I do not know if anybody has ever done that. But to me, I think our fellows did a good job on it. I never tried to change anybody's mind.

We just said, here are some ideas we have to try and stretch out people's view, and try to get this country to begin to look at their industry, the same way the Japanese and the Germans do by giving a break to the long-term capital gains. That is what the other people, you know, the people who we were competing with do. So it is not very original. I am just trying to copy the guys that seem to be doing well.

Senator BUMPERS. Mr. Secretary, I consider you a good friend, and I consider you an honorable man. You are one of my former colleagues that I had no difficulty voting for, but I must say that that is just unfathomable to me.

Would you have any objection if we were going to pass a capital gains tax that we just take the retroactive windfall part of it out, and say we are not going to reward you for an investment you did not make in anticipation of it being taxed at the 15-percent rate?

Secretary BRADY. Well, without studying what sort of effects that has on the old proposition, I would have an objection to it. But, Senator Bumpers, I will go back and look at it and come back to you and tell you what I think, as best I can do.

[The information follows:]

CAPITAL GAINS TAX

Upon reflection, I stand by my initial reaction that it would be a bad idea to make the 15-percent capital gains rate apply only to future investment.

Since the increase in the capital gains tax under the 1986 legislation applied to all future sales, it seems only fair to have this proposed legislation affect all sales also.

Table 1

**Distribution of Net Long Term Capital Gains
For Returns With Long Term Capital Gains in 1985**
(In Percent)

Adjusted Gross Income Class Without Capital Gains	Distribution of Returns With Long Term Gains	Distribution of Long Term Gains	Percentage of Total Returns With Long Term Gains
Less than \$10,000	16.9%	19.7%	5.1%
\$10,000 to \$19,999	16.5	5.9	6.5
\$20,000 to \$29,999	15.9	6.1	9.8
\$30,000 to \$49,999	24.7	12.0	13.6
\$50,000 to \$99,999	19.7	17.5	24.6
\$100,000 to \$199,999	4.5	12.6	56.2
\$200,000 or more	1.8	26.2	76.1
TOTAL	100.0%	100.0%	9.9%

Department of the Treasury
Office of Tax Analysis

March 14, 1989

Source: 1985 IRS Statistics of Income

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Senator BUMPERS. Do you wake up in the middle of the night ever, Nick, and just think that this train wreck is coming or are you pretty optimistic about everything?

Secretary BRADY. Oh, you know, I think you always make money betting against the end of the world, Senator Bumpers. So that is my basic philosophy.

Senator BUMPERS. I agree with you, if you use a little judgment and common sense in trying to avoid it. But I must say this thing is so bizarre, I just cannot believe it. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Bumpers.

Senator Specter.

ARMED CAREER CRIMINAL PROGRAM

Senator SPECTER. Thank you, Mr. Chairman. Mr. Secretary, I join my colleagues in welcoming you here. We miss you on this side of the panel, but absent being a Senator, being a Secretary may even be preferable, who knows.

There have been many questions relating to economic matters, Secretary Brady. I would like to shift gears and talk about another function of the Treasury Department. The Bureau of Alcohol, Tobacco and Firearms relating to the enforcement of the armed career criminal bill, that is an enforcement mechanism which has proved to be highly effective in dealing with career criminals and in dealing with drug sellers.

The legislation on armed career criminals was passed in 1984 by the Congress, defining a career criminal as someone who has three prior serious convictions, then providing that a career criminal found in the possession of a firearm would be subject to a mandatory sentence of 15 years to life. That act was amended in 1986 to include within the offense category the sale of drugs.

The concern that I have, Mr. Secretary, turns on the fact that you have requested for fiscal year 1990 an appropriation of \$227.1 million which is a drop of some \$14 million from the \$241 million present in the current fiscal year, so that there would be a reduction in the number of agents from 3,701 to 3,397—304 agents. And my question to you is, in light of the effectiveness of the Bureau of Alcohol, Tobacco and Firearms in dealing with career criminals and drug dealers, why the reduction and request?

Secretary BRADY. Senator Specter, I had better get the details behind those figures for you. I notice in looking at some of the accounts inside the Treasury that they would look like reductions in expenditures on items such as this, actually wind up being transfers into various other different agencies—work that is done for the Justice Department and elsewhere.

But I would just offer in passing, that I believe last year we dedicated 208 staff-years to investigations under the Armed Career Criminal Act and since October 1986, ATF investigations have resulted in 405 convictions with sentences totaling over 4,000 years under that law.

So I think we are doing what you asked us to do, but in terms of those figures, I am not sure they are right; I am not sure they are wrong, and I ought to get you the figure because you have intergovernmental transfers there. I noticed in the IRS the same thing is

true. It looks like one figure is happening and what we are doing is doing some work for somebody else. And actually, if I had to guess I think it is probably up, but you better let me get the details for you.

[The information follows:]

REDUCTION IN ATF BUDGET

We are not proposing a reduction in the Armed Career Criminal Program. ATF has been hiring aggressively to meet the legislated level of 543 FTE in fiscal year 1989. This number will be maintained in fiscal year 1990.

The fiscal year President's budget for ATF of \$227.1 million and 3,397 FTE includes transfers to other Federal agencies of \$9.5 million and 147 FTE and reductions, savings, and nonrecurring costs of \$11.3 million and 157 FTE.

EFFECTIVENESS OF ARMED CAREER CRIMINAL BILL

Senator SPECTER. Mr. Secretary, I am glad you quoted the statistics on how many man-hours were devoted and how many man-years of sentences were obtained because I was just about to cite those statistics to you to show you what an effective tool the armed career criminal bill is and what an outstanding job the Bureau of Alcohol, Tobacco and Firearms is doing. But it requires more personnel and not less personnel.

In the Appropriations Committee last year, we added the resources, after some considerable analysis on our part, and I would urge you to take a very close look at it, and I believe that you will find that there are many initiatives underway around the country at the present time utilizing that act and utilizing that unit, and I believe that we ought to be strengthening it in appropriations and strengthening it in manpower because it is doing a tremendous job on career criminals and a tremendous job on the drug sales.

For every 100 agents, Mr. Secretary, they will prevent in a 5-year period, 2,400 armed robberies, 3,600 burglaries, and 450,000 serious crimes. When you deal with a career criminal, you are dealing with someone who commits 300, 400 serious crimes a year, and the most effective tool that we have found so far, is the Federal statute where you have prevented attention because many of these people are a danger to the society. You have speedy trial within 90 days, and you have very long mandatory sentences.

And I realize that you have a vast Department and it is not possible for you to be familiar with every single aspect of it, but I think on analysis you will find, that there really is a cut. And it mirrors the position of the Department last year, but it does not take into account what the Appropriations Committee added.

CUSTOMS ENFORCEMENT

The few moments that I have left, Mr. Secretary, I would like to ask you a question about customs enforcement and about your view on legislation which I have proposed to create a private right of action on the part of the injured party to go to court where there is a customs violation which results in monetary damage to the injured party. This follows a line of legislation which I proposed for some time in the trade field where there are subsidies and dumping cases to give the injured party a private right of action.

In light of what has happened in the trade bill last year, it is my judgment that we can await the developments on the new enforcement provisions on reciprocity. But as it relates to customs violations, the concerns about a private right of action do not appear applicable, and I wonder if you had any thought on that or perhaps you might want to study and consider a formal response to having a private right of action to enforce the customs laws?

Secretary BRADY. What I had better do is take a look at it. I know this is something that you feel strongly about with the increased activity that the Customs Department has been engaged in, it is something that we ought to look into and I would prefer to get back to you, Senator Specter.

[The information follows:]

LEGISLATION TO CREATE A PRIVATE RIGHT OF ACTION FOR CUSTOMS VIOLATIONS

I would need to study your bill in order to give you a reaction, but I am advised that the administration opposed a related bill that you proposed in the last Congress for several reasons. That bill created a private right of action for merely negligent violations of the law, it split jurisdiction over Customs law violation between the Court of International Trade and the U.S. District Court in the District of Columbia, and it treated Customs officers as nominal agents of foreign manufacturers or exporters for the purpose of receiving summonses commencing private litigation. Moreover, it created a private right of action for sales at less than fair market value, which is contrary to GATT rules for imposing antidumping or countervailing duties. There was also concern that the private right of action would be used by domestic producers to harass importers. If these problems are also presented by your current bill, I believe that we would find it difficult not to oppose it.

Senator SPECTER. I would appreciate that. The customs field is a very important one. It is simply not possible to have its staff to take care of all the mechanisms and tricks and devices which are used to circumvent our customs laws. There is nothing like the private incentive when there is a loss to have a private right of action, and of course, that does not mean that the complaining party is going to win, but it would give the complaining party an opportunity to go into the Federal court and pursue that claim.

I very much appreciate your responses, Mr. Secretary, and will look forward to the supplements on both the career criminal issue and the private right of action on customs, and I thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.
Senator Kerrey.

FDIC SERVICING OF RTC

Senator KERREY. I would like to ask a question relating to the assignment of the FDIC as the principal entity in the Resolution Trust Corporation. I need to begin with a very genuine feeling that I have toward regulators in general. And that is, simply I do not trust them. And when it comes to financial institution regulators, that distrust really does intensify.

It is nothing personal; I do not harbor any personal feelings toward Danny Wall or Mr. Seidman or any other financial institution regulator. But it is based upon a personal experience in my State where shortly after I was elected, I was told by a State bank regulator that everything was just fine. We had a few problems, but we could work it out.

Then I was told by one institution, in particular, that if we just brought a little additional capital in, he thought we could make it all right. The short of the story is that once we had closed the institution at the urging, in fact, of the FBI, we discovered a 10-year pattern of theft, of strawman loans, and forgeries. The political, the legal, and the social fallouts were catastrophic. We had a seated attorney general who was impeached and resigned. The principals of the financial institution ended up in prison. And the depositors found themselves unable to get the money from the State limit and suffered as a result.

The consequences of that event contaminated every politician, including myself, and the stink of that will never be washed from my hands, never. And as a consequence of that I worry about having the FDIC in the lead. And I wondered if you had considered actually having the RTC take the lead and have the FDIC underneath them. In other words, have a wholly new and separate, and a bit more accountable entity take the lead?

Secretary BRADY. Senator, what we did was, frankly, do the best we could with what we have. We did not think that it made sense at this particular point in time to add another group of regulators. Actually, what we have done is asked the FDIC to do the work for the RTC. They are actually underneath it, but we did not staff up in the RTC with another whole new bunch of regulators. This may not be a great solace to you, but at least we are not trying to create another whole bureaucracy of regulators here. We are taking that institution, the FDIC which seems to have done the best job, giving them the mandate to go straighten this thing out.

We have got people from the Office of the Comptroller, the Federal Reserve, and of course, people from the FSLIC who add to this cadre of people who are trying to deal with this problem. So we have not added a lot of extra people, and maybe that is——

Senator KERREY. I have actually, in the letter and the questions that I will submit to you, have a bit more detail on that. It is merely a suggestion following your offer to entertain any additional suggestions. It would not, it seems to me, require a new bureaucracy, but it would enable us, the politicians, to perhaps get a little more comfort that accountability was going to be possible. And I have genuine fear of that and with all due respect, Mr. Secretary, I would be worried in your position for President Bush as well. It is something that has the potential to foul everybody who touches it.

I think accountability becomes very important, and again I redundantly restate my distrust of regulators in general. My distrust of regulators is particularly strong when it comes to financial institution regulators. I admit that I have got a bias and declare it is not personal. It is not personally directed toward any individuals involved, but I think it will in fact hold up under fairly close scrutiny.

BOND SALE EFFECTS ON INTEREST RATES

One additional question, and that is, does the \$50 billion bond sale represent borrowing of a sufficient magnitude that it will itself put pressure on the interest rates? Is it a borrowing activity that is somewhat at odds with your concern for the rather pitiful low rate

of savings in the Nation and the concern that you have expressed that I share, by the way, for rising interest rates?

Secretary BRADY. Senator, I do not think that, I guess you could say that the resolution of this crises because of its size, I should say problem not crises, because I think it is in hand now, is going to require the Government to spend some funds, and it will require the private sector to spend some funds. To the extent that that adds to the demand for funds, it may have some very small effect on it, but I do not see it as a major factor.

In the case of the REFCORP bonds which is the largest part of this transaction, I would point out that those bonds will be sold over a 3-year period, so that it will attempt to be spaced out and, therefore, will have a lesser effect than if you came all at once.

Senator KERREY. So a slight reduction in the stream flow, but not much?

Secretary BRADY. It would be slight, in my opinion.

Senator KERREY. Mr. Chairman.

The CHAIRMAN. Thank you, Senator Kerrey.

Senator Domenici.

IRS FISCAL YEAR 1990 BUDGET REQUEST

Senator DOMENICI. Thank you very much, Mr. Chairman.

Mr. Secretary, first I apologize for not hearing all of your testimony. As others, I had some scheduling conflicts, but I am delighted to be here, and I will try to limit the questions I ask to appropriations matters. A couple of my questions, however, do have dual effects. I was going to address the issue of increasing interest rates and the pushing up of the discount rates by the Federal Reserve, but I will do that only if I have enough time, Mr. Chairman.

I want to move to an issue that is going to be very difficult in the appropriation process and that has to do with the administration's request for an increase in budget authority for the Internal Revenue Service. If I read the budget submission correctly, Mr. Secretary, you are asking for an increase of \$289 million in budget authority for the IRS. This is the continuation of the beefing up of the IRS for purposes of collecting additional revenues that are not currently being collected.

My reading of your proposal, Mr. Secretary, is that with an additional \$289 million in new budget authority, and we have to appropriate that in the Treasury-Postal Service appropriations bill, you would estimate that you would get \$317 million in new revenues in the first year. You estimate that over 4 years, you would get \$2.3 billion in higher revenues. I am somewhat concerned because we have for at least 3 years been willing to beef up the IRS and then take credit on the tax side for additional revenues collected. Each and every time, we have assumed rather substantial increases in the amount of taxes taken in through greater enforcement efforts. This budget shows that we are going to do this again.

I am wondering if you really are asking for \$289 million for the IRS, and if you are estimating only a \$317 million increase in revenues for that initiative. I get a little bit confused because you are also asking for \$56 million for IRS drug initiatives. I wonder if we

have all of that in the \$289 million increase, or is it \$289 million plus \$56 million for IRS drug-related activities?

Secretary BRADY. Senator Domenici, I cannot answer that, I better get it back to you. I think the \$250 million plus figure is accurate, but whether that drug-related figure is in it or not, I will have to get the answer for you. I do not have it with me.

Senator DOMENICI. Would you please do that. I think that is a direct appropriation, and we really need to know that. Would you also give us your current estimate of the enhanced revenues that will be realized by beefing up the IRS to that extent. We need that for the record, too.

Secretary BRADY. I would be glad to supply that at the same time.

IRS DRUG INITIATIVE

Senator DOMENICI. Since legislation is understandably slow in coming up to the Congress, I would appreciate it if you would at least outline what the IRS drug initiative is? I understand you have a role for the IRS, but I do not know what the \$56 million is for.

Mr. Secretary, I was not present to hear the questions of the distinguished chairman with reference to the S&L reform package. In addition to whatever else has been asked of you, I wonder if you would break down in your answer, so that we would understand what you expect, total disbursements and total collections under the President's S&L plan. That should yield net outlays for the plan.

INTEREST PAYMENTS

Then we need to know what you estimate the interest payments on the new bonds to be. As I understand it, we have another item and that is additional collections that FDIC is going to receive because the insurance fee paid by banks is going up. They are going to pay an additional fee to make their fund solvent.

We need those figures with as long a flow as you can put on them. I clearly understand that once you get past the first year, we are dealing in estimates in all of them, both as to collections and as to the amount to be paid out in interest by the Treasury.

I think we are not quite understanding which interest is being paid by the fund itself and which interest is being paid by the taxpayers. My hunch is that some of the numbers we are talking about here have both involved. From the standpoint of the appropriator, we need to know what we have to pay out. We ought to understand what the institutions are paying out as well. It is not all coming out of appropriated accounts. I think we need those breakdowns, if you could give them to us.

Secretary BRADY. I will be glad to.

Senator DOMENICI. With reference to capital gains—

The CHAIRMAN. Senator Domenici, I wonder if I could add to that request on that point. Could you also indicate with asterisks the amounts that would accrue anyhow regardless, irrespective of the S&L crisis and the program that you have put forth to deal with it.

I should think that some of these items that would be collected, old collections and so on, would accrue anyhow.

Secretary BRADY. You mean the deposit insurance fees that are coming in now, for example.

The CHAIRMAN. Yes, some of these items would accrue anyhow and if they were indicated by asterisks, it would give us a better picture then of the real total cost to the taxpayers. If you understand what I am saying to you. If you do not, I will try to say it better.

Secretary BRADY. No; I think I understand. Let me take a crack at it anyway. I think many of these figures are already out in Director Darman's statistics, but let me have a look at those and see whether they are adequate.

[The information follows:]

INSURANCE PREMIUMS

Our plan does not count as additional collections any insurance premiums that are already being collected. We have counted only those additional collections that would result from our plan's proposal to increase bank insurance premiums. These additional collections amount to \$19.9 billion between 1989 and 1999.

With regard to thrifts, our plan proposes an increase in insurance premiums (from 20.8 to 23 basis points) for only 3 years, but a decrease (to 18 basis points) thereafter. Thus, our plan actually estimates somewhat lower collections from the insurance premium on thrifts than it would if one simply projected receipts based on the current premium rate.

PRESENT VALUE

Senator DOMENICI. Let me suggest, Mr. Secretary, and I may be the only one that is concerned, but frankly I do not think anyone understands when you use the present value of the expenditure. I would hope that as you put present value in these charts that you explain it. You had a very good way, when you were a Senator, of explaining complicated Wall Street issues in our terms.

Present value is a very important concept, but more of us have to try to understand what it means. When you use present value, I hope you will give us a little narrative about how it is used in the marketplace. I think a good example is buying a house. If the value is \$50,000, that is what you pay for it, but you make \$200,000 in payments over 30 years. If you are financing \$50,000, that is, in effect, the present value and the rest is interest that we are paying, because we do not want to pay the \$50,000 right now.

I do not think anybody understands that. If you would give us a description of the term, I would personally appreciate it.

Secretary BRADY. All right, fine. The other thing, Senator Domenici, is when you use the example of the house, in this discussion we talk about it of the cost plus interest over time, but we do not give ourselves any credit for what the value of the house is at the end of the process. In other words, it is not right just to talk about interest. I mean, nobody would pay interest and buy a house if they did not think they were going to get something out of it.

So I think part of that concept that makes it hard to talk about is you have to estimate what the future value of the house is before you can see whether you have done something intelligent or something silly.

NET LONG-TERM CAPITAL GAINS

Senator DOMENICI. Let me ask a question now about capital gains. Again it is not directly within this committee's jurisdiction, but it becomes somewhat relevant as the budgeteers and appropriators discuss whether it makes sense for this proposal to be a tax loser or a tax gainer. I understand your position.

I would like you to submit for the record what the distribution of the net long-term capital gains is with reference to different income brackets. I think that has been done in the past. This approach has been labeled a rich man's tax and other kinds of things, and I believe it will be useful to see the income distribution under that proposal, please?

Secretary BRADY. We could.

CHILD CARE TAX CREDIT

Senator DOMENICI. I'd also like to raise the child care tax credit proposal. Again, this is a tax issue, but very important to this committee, because if we are going to pay for the President's plan or any other plan, we have to fit it within the budget. If we spend on the tax expenditure side, we have to spend less on the appropriations side to meet the budget targets.

So I am going to ask you when you think the administration is going to transmit its legislation regarding the so-called child care tax credit. I personally think it is a good proposal, but I have not seen the details. Do you know when that might be ready?

Secretary BRADY. I am told it is in draft form, Senator Domenici, it ought to be available for inspection 2 to 3 weeks.

CONSIDERING S&L COST ON-BUDGET

Senator DOMENICI. I will submit two or three other questions with reference to the S&L situation, some of which have to do with putting more of the cost on-budget. That issue has been discussed very much in detail here, and I understand your concern about an exemption from Gramm-Rudman-Hollings.

I submit to you that the danger is whether you open the law up to all kinds of changes, not whether it would adversely affect the market, but that is just my view. The S&L fix is not a recurring item. It was never contemplated to come within the Gramm-Rudman-Hollings deficit totals. It is like an earthquake in Alaska that we would spend \$3 billion on; we certainly would not cancel \$3 billion in other programs to pay for it. This is just a big disaster like a major earthquake.

I think the issue is whether it is more prudent to assume the costs on budget. If so, would you affect everybody else that wanted to get out from under the target? I think that issue deserves attention.

Secretary BRADY. I understand your thinking on that, Senator Domenici, I respectfully hold another view, which is if you do it for—who defines disasters, it is a question of who has got the paintbrush and I think people who are looking at Gramm-Rudman, as imperfect as it may be, as much as we could change it, look at it as a system that works. I am sure that it could be more perfected.

Senator DOMENICI. That is a good answer. I think if you stand on that and say we are fearful that we will yield to putting all kinds of "disasters" outside of the Gramm-Rudman targets, then that is a serious issue for the Congress. I do not think that the argument that the budgetary treatment would affect the marketplace one way or the other is a good one. That is just my view.

REDUCING INTEREST RATES

My last question, Mr. Secretary, is with reference to the American economy and interest rates. I am sure that by this time, there are all kinds of views as to how we would go about getting interest rates down. One of those is that we ought to get rid of the Federal deficit, and I understand that. But I am very concerned that the Federal Reserve is walking a tightrope, and the rope may break.

The tightrope is that they want to ratchet interest rates down, ratchet them up so that interest rates down the line will not be higher than now. That is what they have explained.

At the same time, the Fed is concerned with inflation and the plant capacity concepts they are using. I am really very worried, because it seems to me that if they have a policy, it ought to be based upon some very serious recommendations to the people of this country and the Congress. They are the only self-fulfilling prophets around. They can cause a recession; no one else can.

I think we ought to, and you ought to, insist that if they are saying that, they ought to give us reasonable assurances that if we reduce this deficit under the Gramm-Rudman Act, in a credible way, that there is a high probability interest rates will be effected positively, or that they would consider changing their policy of high interest rates.

I think without that we are totally in the dark. We are going to ratchet out this economy even if we get to the Gramm-Rudman targets, and I really believe that is inviting a blunt instrument to control things, rather than something far more desirable. I think the Fed should tell us a little more specifically what we ought to do, and then you ought to join with the President in telling the people how to get the deficit down and how it will alleviate this problem. If not, I think we are in for some very unexpected consequences. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Domenici.
Senator Mikulski?

SCORING FUNDS FOR S&L PROBLEM

Senator MIKULSKI. Thank you very much, Mr. Chairman. Mr. Chairman, this is really the first hearing I have had an opportunity to attend with you as the new chairman. Thank you for holding these vigorous fiscal year 1990 budget overview hearings with Office of Management and Budget Director Darman and now with Treasury Secretary Brady.

Mr. Secretary, my questions will have to do with the S&L crises. By way of perspective, I chair the Subcommittee on VA, HUD, and Independent Agencies, which includes the Federal Home Loan Bank Board. The chairman, Senator Byrd, and I have discussed our

responsibilities as appropriators in dealing with the cost of the administration's S&L bailout plan.

The administration's plan has been characterized by a lack of specifics on how the Federal cost of the bailout plan are going to be scored for this committee, how it is going to affect the Gramm-Rudman deficit targets, and where the offsets for these costs are going to come from. In certain areas I know some issues about the total Federal cost have been discussed. The Appropriations Committee, however, has to enact our bills by October 1. As a result, we need answers to our questions on scoring relatively soon.

So by way of background one of my questions would be, how much of the Federal funds that would be spent on the S&L bailout of the \$94 billion, will be allocated to the Committee on Appropriations as opposed to the Banking Committee? I know that might be a tough question to answer at this stage of the legislative process and that you might have to come back to us with a response for the record on that.

Secretary BRADY. I think I better come back for the record; I cannot answer that.

Senator MIKULSKI. But we really would like you to give that every consideration. How many new appropriation accounts do you think would be created under the Bush S&L bailout accounts?

Secretary BRADY. I cannot answer that either, Senator Mikulski.

Senator MIKULSKI. Mr. Secretary, please understand I am not trying to stump you on these questions. I think you understand, we are trying to determine how much discretionary funding we need to meet our programmatic responsibilities in fiscal year 1990. As a result, we need to know how much of the cost of the S&L bailout plan will be scored to the Committee on Appropriations as mandatory appropriations, like an entitlement, and therefore not count toward the discretionary portion of our committee's 302(a) allocations. If the cost of the administration's bailout plan is considered discretionary, it will place enormous pressures on my subcommittee which has to fund veterans, housing, the space program, basic civilian research, and the environment.

Secretary BRADY. We have put forward the figures, Senator Mikulski, I did not realize and I am not sure it is our responsibility to decide how they go between the budget and the Appropriations Committee.

Mr. Chairman, maybe you could clear up this. I do not know the answer to that question.

Senator MIKULSKI. We are trying to determine how the administration expects these bailout costs to be paid for in the annual budget process. I do not know if the Chair has any comments to make on it.

The CHAIRMAN. I doubt that the Secretary of the Treasury would be the person to press this particular question on.

Some of the preceding questions, Mr. Secretary, I believe you indicated that you did not have the answers to, but I hope you will supply them for the record; will you do that?

Secretary BRADY. I am sorry.

The CHAIRMAN. The preceding questions that Senator Mikulski asked, will you supply the answers for the record?

Secretary BRADY. Yes, I will, Senator. I thought it was up to the Budget Committee as to where these——

The CHAIRMAN. I have just said that I do not think that this particular question is the one that need be directed to you.

Senator MIKULSKI. But we do need to know how the administration expects the money will be spent on the S&L bailout. Will it be allocated to the Committee on Appropriations or to the Banking Committee or perhaps different pieces of the plan to each?

Secretary BRADY. Yes, we will try and be helpful on that, Senator, I just thought that was a congressional matter. But I may be incorrect and if I am, we will do that.

[The information follows:]

SCORING OF FUNDS SPENT ON S&L's

OMB is the agency that determines how those funds are scored. They do this as part of the technical amendments they provide with the legislation. It is our understanding they are still reviewing different methods of scoring.

Senator MIKULSKI. We know that the hour is getting late, Mr. Secretary, and perhaps we can have further conversations with you and Mr. Darman on this matter. Thank you very much for joining us today, and we look forward to working with you.

The CHAIRMAN. Senator Mikulski, we will be trying to assist one another in connection with the scoring and I would imagine that the OMB Director could probably be very helpful in that regard, more so than the Secretary of the Treasury on that particular question. Did you have any other questions?

Senator MIKULSKI. No, sir; I know that the time is moving.

The CHAIRMAN. Thank you, Senator Mikulski.

Senator Grassley?

NATIONAL ECONOMIC COMMISSION

Senator GRASSLEY. Mr. Chairman, thank you very much. Secretary Brady, my first question is asking your views on that part of the National Commission on the Economy or the National Economic Commission; I forget what its official title is, where they had criticism and it was on both the part of the majority, as well as the minority regarding concerns that the social security surpluses are being used to make the deficit appear smaller.

There is support from both the majority and minority, and the report from legislation to establish deficit or surplus targets to gradually eliminate the non-social security deficit which would go beyond Gramm-Rudman and that is what I would like to have your view on?

SOCIAL SECURITY SURPLUSES

Secretary BRADY. Senator Grassley, obviously if you take out the social security surpluses, the budget deficit goes up, but it goes up in such magnitude that if that were the way to look at it, we would have to take the Gramm-Rudman system and make some adjustments in that. So all I can say to you, sir, is that when the people that put Gramm-Rudman together, they knew of these surpluses and they included them in the calculations. So if you want to take

them out, I think, you probably have to make adjustments in the Gramm-Rudman totals.

Senator GRASSLEY. Without a doubt, and what I am interested in is your view whether or not that ought to be done.

Secretary BRADY. I do not think it ought to be done because social security has been in and out of the budget for a number of years and I think we ought to leave it where it is. On the other hand, and I think that if you do that at this point in time, you will create confusion. I think it is important to do what you have done which is call attention to the fact that there is a big surplus in there and make sure everybody knows we have not cured the world, just when we hit the \$100 billion target.

UNTIED LOANS

Senator GRASSLEY. Next I want to bring up the subject of untied loans by Western banks to the Soviet Union. And there is growing concern regarding the issue of these loans to the Soviet Union. And you know that hundreds of millions of dollars are being loaned to the Soviets by these Western banks with no specific authority or security, no required payment on the principal for a number of years, and maybe for no specific purpose, spelled out in the request for the loan.

Now I hope you understand that where this comes to roost with me is the fact that Iowa small business people and the Iowa farmers, and I am sure, it is the case for Oregon, a case for West Virginia, a case for Nebraska, Maryland, that our people see our banks foreclosing, not extending loans, and then seeing these banks extending loans. Like for instance last year or maybe it was 1987, I forget which year, Hungary could not pay for loans, and the First Chicago and other Western banks just postponed payment for 4 years.

Now last year the Senate passed a resolution, so that brings it back to what we have been involved with here in this body, requesting our Government to consult immediately with allied governments on the impact of these loans on our national security and financial stability. So does the administration view the issue of untied loans to be a problem and if it does, is the administration taking any action regarding the growing concern, if you considered it a concern? I want you to know it is a concern on the part of many of us in the Senate because this resolution passed.

Secretary BRADY. Senator Grassley, actually at the G-7 meeting which occurred in February here in Washington, I brought up the subject of untied loans with the finance ministers and central bank governors of the other six nations and stated the concern that you have put forward this morning with regard to their own lending practices. And in their case, they took the point, I cannot tell you they will be as forceful as we are in the United States, because obviously they are neighboring countries to Eastern Europe and the Soviet Union, but I made our point very forcefully to them at that particular point in time, and hope that by continuing emphasizing this with them over time, that we will be able to make some sort of an impact.

Senator GRASSLEY. Let me ask you this. Let us suppose they are reluctant to act and I do not know whether there is an insinuation in your approach that we have to act in unison or we cannot act, but even if our allies are reluctant to act, what can the United States do on our own, other than the job owning you have talked about to curb these potentially dangerous transactions. I mean dangerous from the standpoint of financial security?

Secretary BRADY. I think that in the first instance that job owning is the right thing to do. I think that it would be probably the wrong way to go at it to pass a law which said, you shall not invest in country X, Y, and Z because it has foreign policy implications. As you know, I am not trying to juxtapose the farmers in Iowa against people in Hungary because I would tend to agree with you, but to put a law on the books, I think, probably is going a little too far.

I think talking about it gets everybody's attention frankly. And I think also, Senator, these loans have not been an unqualified success, and I think that the disposition of people to lend to Hungary and countries like that probably now is a lot less than it was when their loans were put on the books.

Senator GRASSLEY. I would only summarize on that point from my own view, but also in a way of advice that I would hope that if we consider it to be a problem, and if we consider job owning to be the method of trying to accomplish our goal, and that if we find out after a period of time that that does not work, if we do not have some sort of backup plan, than I do not know whether we can be taken very seriously by our allies that we are serious about a policy in the first place. I just suggest that.

STRATEGY FOR S&L SUPPORT

Now I want to go over the savings and loan issue. This is something that I am reiterating, a concern that I raised with you when you testified before the Senate Budget Committee, and I said then, much of the public is unsympathetic to the crises in the thrift industry and does not support a taxpayers bailout of FSLIC.

Last week you indicated that it is, I think this is a quote, "Simply necessary to enact the President's plan as quickly as possible," implying that Congress and the American public then would solve the problem, and in the process it is a good remedy, so swallow the pill and hope that it works. Now I feel strongly, Mr. Secretary, that even if the medicine is a quick prescription, that the co-operation of the patient and public is essential.

Therefore, in order to ask this committee, indeed, the entire Congress to approve an appropriation to bail out the thrift industry, I hope the administration would be inclined to lend its support in carrying the message to the public. When you addressed my question and before budget, I received the impression that the administration does not now have a strategy to build public support for the taxpayers bailout at FSLIC. So my question is, is that a correct assumption on my part that you do not—

Secretary BRADY. If I gave that impression, Senator Grassley, it was exactly the reverse of what I intended to give. I think that as the President and his remarks at the press conference announcing

his plan did point to the fact that this was a burden on the public, but that it was at this moment the plan that he saw that took as it could in the way of funds from the industry without making it a self-fulfilling prophecy by putting more on them, that we would just have a bigger problem.

So if I in any sense indicated insensitivity to that point, it is a reverse of what I intended, and we will help.

Senator GRASSLEY. I think it goes to the point of, do you have a strategy for developing public support for the plan? In other words, so that we in the Congress, I suppose I am asking to make our job easier, but I do not know where you can have the focal point, if you cannot have it with the President of the United States that this is so essential, such a crucial issue that we have got to go this direction to do it and build a public support for the program because it is not there today.

Secretary BRADY. To the extent that he did not do that in his press conference, I know that he feels that way privately, so that I am sure that that will be the outcome.

Senator GRASSLEY. Here is what I am thinking in terms that there ought to be some plan, that so many people are going to be on so many talk shows, so many television programs, so many news conferences, till you finally get this message through. That is the point that I want to make.

THRIFT INDUSTRY

This will be my last point. And this is the fact that it is my recollection from the papers that you have repeatedly stated it is the position of the administration to maintain a separate restraint thrift industry and that that industry should be primarily dedicated to home mortgages as historically been. It is my recollection that the President, while he was Vice President, chaired a task force which examined the financial institutions, in particular, savings and loans. That task force recommended in general terms that the thrift industry was not essential to provide sufficient credit to home buyers.

It is also my understanding, Mr. Secretary, that Richard Breen also served on that task force and is now the President's chief advisor on the thrift crises. If I were to draft a plan for the eventual resolving of the thrift industry, I would think the first step would look an awful lot like your program before us, which resolves savings and loan crises, where you have common management, the insurance funds, common jurisdiction by Treasury over regulators, and identical regulatory standards.

So my question to you, Mr. Secretary, is that coincidence or is there some grand scheme regarding the various structure and existence of the thrift industry that has not been made public?

Secretary BRADY. No, there is no such grand plan, in fact, quite the opposite. There are provisions in the funds that are put together here for rebuilding of the insurance fund that stands behind the savings and loan industry. We are trying to strengthen the industry by increasing the capital requirements that the industry has to put up.

We note that there are a lot of very fine, strong S&L's who have stuck to their knitting who have the capital to stay the course. And our plan does, I would say, quite the reverse, Senator Grassley. We were trying to put the industry on a footing where it would be a strong competitor and do what it originally was set up to do, which is to provide mortgage loans to people needing houses.

Senator GRASSLEY. Let me ask in conclusion, even if there is not such a plan or scheme or the result of this plan, might not the thrift industry eventually be subject to argument that if savings and loans look more and more like banks that the distinction should eventually be eliminated?

Secretary BRADY. Looking way off into the future, that is anybody's guess. But I would say that in the near term, at least based on what we have said, there is different powers for savings and loans. They are granted much wider powers than commercial banks, and I think that that would make them a separate and distinct industry.

Senator GRASSLEY. Thank you, Mr. Secretary. Mr. Chairman.

FOREIGN HOLDINGS

The CHAIRMAN. Thank you, Senator.

Mr. Secretary, in your opening remarks, you stated that in 1986 foreigners held almost \$400 billion more in U.S. assets than foreign assets held by Americans, and that 10 years ago this difference was \$50 billion in our favor. It is a sad state of affairs to see that in 10 short years, we have transferred almost \$0.5 trillion of the Nation's wealth to foreigners. We have the Japanese owning almost three-quarters of the office market of downtown Los Angeles, and foreigners owning nearly one-quarter of the office market of our Nation's Capitol. 10 percent of the property in Maine, 25 percent of downtown Atlanta, and large stakes in San Francisco and New York City.

The Washington Post reported recently that FSLIC offered a portfolio of \$10 billion in assets from failed savings and loans to European investors. It is ironic that the industry created to promote home ownership in the United States is now having to pedal American real estate abroad. No one knows exactly how much American real estate is now in foreign hands, because there is no comprehensive continuing system for tracking foreign investments in the United States.

I have two questions. One, in light of the figures quoted in your statement and the active effort to sell off assets of failed S&L's to foreigners, do you not believe that it is time to establish a system to carefully track and monitor foreign investments in the United States?

Secretary BRADY. Senator, we have rough statistics as to what foreigners own in the United States, and although the figure has been climbing in recent years, I do not believe it yet has reached a level which we should be worried about, and it is below levels at which it was in the past. And if you go back far enough, of course this whole country was developed on foreign capital and as long as they continue to have confidence in our ability to carry on business, it is a place that is perfectly satisfactory to get funds. I do not

think it ought to go in terms of the budget deficit. I think we ought to decrease that in order not to put ourselves any further into that particular concern. But I think it is at a level now that is manageable.

MONITORING FOREIGN HOLDINGS

The CHAIRMAN. Well, you did not answer my question, Mr. Secretary, do you think we ought to have a system that would carefully monitor and track; why not?

Secretary BRADY. Because I think, Senator, it depends what that system looks like. We think we already got in this country our requirements for registration to foreign security purchases which are equivalent to those around the rest of the world. And we do not want to put ourselves at a disadvantage and get into a competition with foreign governments as to listing the assets that are owned by other than their own nationals. So, respectfully, I think we have got enough information right now.

The CHAIRMAN. So you are saying we do not need a reporting system on this score?

Secretary BRADY. That is correct; I think we have a reporting system now and it is adequate.

The CHAIRMAN. Would you say the \$400 billion is an accurate figure with respect to what—

Secretary BRADY. I think that as of the date that that figure was said to be case, that it is accurate.

The CHAIRMAN. That was as of 1986; what would be the accurate figure today?

Secretary BRADY. I do not know exactly what it is. There is such a figure. I believe it is a Federal Reserve figure and I could get it for you. We just did not have it at the Treasury. I think it is more than that, more. It could be as high as \$460 or \$470 billion, is my understanding.

The CHAIRMAN. Would you submit that for the record?

Secretary BRADY. Sure.

[The information follows:]

INTERNATIONAL INVESTMENT POSITION OF THE UNITED STATES

At year end 1987, the latest date for which data are available, the value of U.S. assets abroad was \$1,167,807 million; the value of foreign assets in the United States was \$1,536,040 million. Thus our net investment position was negative \$368,233 million.

I am submitting for the record data on our international investment position extending back to 1972.

[CLERK'S NOTE:] Data submitted unsuitable for printing and is being retained in committee files.]

REVERSING THE TREND

The CHAIRMAN. What else can we do to reverse this trend so that we get back to where we were 10 years ago.

Secretary BRADY. Well, to reverse the trend it would be something that many factors are involved in. I do not particularly see great alarm in the fact that we have this level of ownership by foreign securities holders. In fact, it represents the fact that they think it is the best thing that they could do with their money. If we

could use their money, that is fine. I just do not know if it ought to get too much bigger. But right now, it is at a level that is within the boundaries, that of levels we have endured before.

The CHAIRMAN. Mr. Secretary, with all due respect, you may not see much to be concerned about here, but a lot of people do. I know a lot of my constituents do. I do. I am not suggesting an additional regulation, I am suggesting additional reporting, a tracking system, a way to monitor this. What is wrong with knowing what the accurate figure is with reference to the foreign-owned assets in this country.

Secretary BRADY. I think within enough range, Senator Byrd, to do the thinking we need to do whether it is good or bad. We have those figures now. I would be very surprised if those figures that I have in my speech were not pretty nearly the right figure.

The CHAIRMAN. But you would not want to bet your shirt on it; would you?

Secretary BRADY. Well, probably not my shirt, but I would bet it is pretty close. I think for 1986 it is pretty close. In fact, it is probably understated.

The CHAIRMAN. I think all that begs a question. It may be pretty close, and I am in no position to dispute that. What I am saying is, what is wrong with having the tracking system, and I think you are saying we do not need it, and what we have are figures that are close enough. That is where we differ?

Secretary BRADY. Yes, sir; it is kind of like using a slide rule and a calculator. I mean if you are trying to think about the thing broadly, a slide rule is good enough.

STUDY OF THE S&L PLAN

The CHAIRMAN. It is not bad to have the calculator, as well.

Now just one more look at the \$125 million. The reason you are suggesting that that not be on budget is because you are trying to avoid Gramm-Rudman-Hollings; is it not?

Secretary BRADY. No, it is not. What I said, Senator Byrd, was that this bill which should be questioned and the way it has been questioned, I have no argument about that. It is the result of 3 months' study of this problem, trying to balance the various elements that we have to balance in order to get the next step, which is to get a solution to this problem. We had numerable conferences with people in the industry—S&L industry, the banking industry, regulators, Members of Congress, and the like, and this is the system that we came up with.

What it does, I think, again, I am not questioning the request for information, but I would say that some institution in Washington, DC, has got to gather everybody together and say here is a plan, that we have the energy, maybe not total enthusiasm but we have the compliance of most of the people here involved in this problem. That is what we tried to do. The budgetary effects are what we have spelled them out to be in some \$40 billion over the period between now and 1999.

I do think in the sense, that if you ask me, do I think that this is better to do it this way, to put it all on budget, as an abstraction, I

think it is better to do it this way. But I can understand, sir, how there are differences of opinion.

The CHAIRMAN. It would seem to me that there would be a better approach and that would be to put it on the budget. And you save the American taxpayers \$125 million a year, \$1.2 billion in 10 years, \$3.8 billion in 30 years in interest premiums, while still collecting all that your plan anticipates from the industry. We could still collect that from the industry, have it on budget, and the taxpayer would be saved that amount. It seems to me that the taxpayer did not cause this problem, and we ought to try and save him all that we can.

Secretary BRADY. I respectfully disagree, Senator Byrd, I think this is the best plan that we can come up with. We put forward 333 pages of legislation, some 10 or 15 pages of OMB figures, stretching out to 30 years, and again, I know there is a disagreement here with regard to the 25 basis points. People assume that the industry would just gladly do this. You do not have to do it this way, you could do it some other way.

Well, I have to say, that we have spent an awful lot of time trying to push these guys to do the plan this way. If somebody else can go out and make them do the same thing for some other plan, I would be glad to look at it, sir, but I just know how long it took us to get the industry to put the money up for this plan. So if somebody else can produce some other plan, then I would be glad to look at it and give you our comments.

CLOSING REMARKS ON S&L PROBLEM

The CHAIRMAN. I do not think the industry is in the position to do much bucking. It seems to me the industry stands in a disreputable position before the American people. So I do not think we have accomplished anything much in getting the industry to come forward, as you have indicated. I say that they could do that and we could still put the item on budget, save the American people that \$3.8 billion, that is \$3.80 for every minute since Jesus Christ was born, \$3.8 billion in 30 years.

Secretary BRADY. Well, the statistics—I was fooling with one the other day, Senator, I figured out you could give 900,000 people in this country a \$100,000 home with what we have finally come up is a \$90 billion, how big this problem is. So statistics are something that can make you think different things at different times.

The CHAIRMAN. I think we have come up this morning with more than \$90 billion costs to this program. You just used that figure just now as the cost of the program to the taxpayers. I think that this hearing will show that the cost is considerably more. We are talking about \$98.1 billion in one place for one program over a period of 30 years. Then we have the other program for which you do not have the figures yet, even for 10 years, in which according to my figures a moment ago, were something like \$17.8 million cost to the taxpayers in interest just for 10 years. So you do not have those figures yet.

I think that has been made pretty clear by this hearing. I say that most respectfully. I congratulate you on the efforts that you have put forth. The work that you have done. You are sincerely

trying to deal with the problem. I do not think the number of pages in the bill has much to do with it, just as I do not think the number of pages in the various memoranda that have been submitted to the Congress by Dr. Darman can make a great deal of difference, and I said that to him when he was before the Committee.

But in any event, I think we have had a good hearing. There has been a great deal of attention on the part of members. We have had good attendance, and I hope that the results will be helpful to the Appropriations Committee and will give you, Mr. Secretary, some additional cause for thought and hopefully produce something good from the standpoint of changing your thinking and the administration's thinking in respect, in particular of getting the figures out front, putting them on the table, and let the American people know what the price tag for 30 years, and also giving a second thought to putting on budget the item that is otherwise going to cost the American people \$3.8 billion over a period of 30 years.

If you have any further comment, I will be happy to hear it. If not, I will ask Mr. Hatfield if he has anything else.

Senator Kerrey?

Mr. Secretary?

Secretary BRADY. No.

[The following questions were not asked at the hearing, but were submitted to the Department for response subsequent to the hearings:]

SUBMITTED QUESTIONS

QUESTIONS SUBMITTED BY SENATOR INOUE

Question. Based on the President's reform proposal for the savings and loan industry, do you believe the industry can continue its dedication to home ownership?

Answer. The Administration's proposed Financial Institution Reform, Recovery and Enforcement Act of 1989 (FIRREA) serves as a blueprint for comprehensive reform and sound financing. It is designed to permit the reemergence of a healthy and strong savings and loan industry and for this reason is pro-industry both for savings and loans and for the housing industry they serve.

Our proposal includes incentives to promote housing finance. Under both the thrift and bank regulators' proposed risk-based capital guidelines, financial institutions will be encouraged to hold mortgages since their risk will be weighted at 50 percent. The low capital risk-weighting for residential mortgages, and the resulting reduced need to hold capital behind these collateralized loans, will make mortgages a more attractive investment.

The plan also supports housing finance by providing continued access to funds from the Federal Home Loan Bank System and retaining a viable thrift charter. The charter will assure that thrifts fulfill their public policy mandate of supporting housing finance by requiring them to hold 60 percent of their assets in mortgage or mortgage-related activities. However, the charter also allows thrifts to diversify, which is necessary given the inherent interest rate risk in mortgage investments.

In short, we think our reform package is good for the housing industry.

Question. The President's reform proposal requires that all savings and loans meet the capital requirement applicable to FDIC-insured banks by June 1, 1991. Will all savings and loans be able to meet the capital standards by June 1991. Is this a practical date?

Answer. The President's plan assumes that all 345 institutions currently insolvent under generally accepted accounting principals (GAAP) plus 150 institutions that are marginally solvent will be resolved by the Resolution Trust Corporation.

However, most of the other institutions should be able to meet the capital standards. Fifty percent of all solvent savings and loans currently have at least six percent GAAP capital. Using risk-based capital accounting, OMB estimates that 74 percent of all solvent savings and loans meets the standard.

Of the solvent thrift institutions, 87 percent with 80 percent of the assets have at least three percent GAAP capital. The GAAP solvent institutions have an aggregate GAAP net worth of \$52 billion, and net operating income of \$5.8 billion. Many of these institutions in the three to six percent capital range undoubtedly have chosen to maintain capital at the lowest possible level and still remain in good regulatory standing. The overwhelming majority of these savings and loan associations should be able to meet the six percent requirement by 1991.

As they have done in the past, thrift management can achieve higher capital levels in many ways, such as: (1) retaining profits instead of paying them out as dividends; (2) issuing more common stock, or a certain amount of preferred stock or subordinated debt; (3) shrinking assets; or (4) merging with another institution. (It is worth noting that the 1,218 healthy thrifts with greater than 6 percent capital have \$8 billion of capital above the 6 percent threshold. This of course does not include commercial banks that would be able to acquire thrifts 2 years after the FIRREA enactment.)

Finally, the capital threshold is not a "make it or liquidate" standard. If a thrift has a realistic business plan and demonstrates substantial progress toward reaching the threshold, the appropriate Federal regulator can use its supervisory capacity to extend the time period allowed to meet the capital requirement, although the institution would not be able to grow further. Moreover, it is highly unlikely that a regulator would liquidate any thrift with substantial capital since merger is the cheaper alternative.

Question. Does the President's proposal assume a consolidation of savings and loans? If so, by how much.

Answer. We do assume that there will be some consolidation of the industry, although it is presently unclear how much will occur. Merging with a well capitalized institution is certainly one way an undercapitalized thrift can meet the proposal capital standards. In addition, the Administration proposal would allow bank holding companies to acquire failing institutions immediately and healthy institutions 2 years after the enactment of the FIRREA.

Question. The reform proposal would increase insurance premiums for commercial banks to 12 cents in 1990 and 15 cents in 1991. As a result of the increase in insurance premiums for FDIC-insured banks, can we assume that the banking industry's reserves are low and that its insurance fund is in trouble.

Answer. The FDIC's ratio of reserves to insured deposits fell to an estimated all-time low in 1988 of .83 percent. We propose increasing commercial bank premiums to bring the FDIC fund back in line with its historical reserve-to-deposit ratio in order to protect depositors and taxpayers.

With regard to the safety of the FDIC fund, Chairman Seidman has predicted that the number of bank failures peaked in 1988 and that the fund's reserves should increase slightly in 1989. (Reserves fell by about \$4 billion in 1988.)

Question. Under the President's proposal, who should mandate any further increases in the insurance premiums, the Congress or the Federal regulators (FDIC)?

Answer. The FDIC would have the authority to raise either bank or thrift premiums when (1) their respective fund to deposit ratio falls below 1.20 percent; (2) their respective fund has experienced a net loss during any one of the previous 3 years; or (3) the Board of Directors determines that there is a reasonable risk of serious future losses.

The maximum annual increase in each fund's assessment could not be greater than 50 percent over the assessment rate of the previous year and the annual assessment rate could not exceed 35 basis points.

The FDIC could set a lower assessment rate for the thrift or bank funds when the respective fund's reserve to deposit ratio is greater than 1.25 percent and it is likely that fund losses will not occur within the next 5 years.

Question. The banking industry is concerned over the savings and loan industry's use of the FDIC emblem. It implies that existing FDIC funds back savings and loan institutions. It further implies that both banks and savings and loans have equal charters and powers. If the Administration is considering allowing the savings and loan industry to use the FDIC logo, is it also considering the lifting of the more restrictive requirements that govern the banking industry and thus bring both into parity? Should this matter be addressed in the proposed law?

Answer. The Administration's proposal gives the FDIC the authority to determine the specific FDIC logo used by banks and thrifts. However, Section 218 of the FIRREA states that such signs displayed by financial institutions will represent whether the institution is a Bank Insurance Fund member or a Savings Association Insurance Fund member.

Question. The President's proposal would utilize the resources of District Federal Home Loan Banks which are owned by savings and loan institutions. What is the justification for utilizing these resources?

Answer. The FHLBanks are considered a government sponsored enterprise which enjoy many benefits including: (1) a lower cost of funds due to an implicit Federal guaranty of the bonds issued and the exemption of interest paid on these bonds from state income taxes; (2) use of the Federal Reserve as fiscal agent; (3) exemption from SEC regulation; (4) exemption of corporation earnings from Federal and state tax; and (5) the eligibility of FHLBank bonds for unlimited investment by national banks, state Federal Reserve member banks and thrifts.

In addition, the U.S. Court of Appeals has ruled that the FHLBanks are Federal instrumentalities organized to carry out public policy, that their members are only nominally shareholders and that neither the Banks nor their shareholders possess "any of the purely inherent characteristics and attributes of orthodox private corporate business enterprises."

It seems appropriate, therefore, that member institutions of the FHLBanks forgo some of their earnings from the FHLBanks to meet their responsibilities for assuming some of the cost of the thrift problem.

Question. With respect to the directorship of the Federal Home Loan Bank System, the President's reform plan reduces the directorship from 14 to 9 members. This places the savings and loan institutions at a disadvantage as they would be losing its majority. What is the justification for this change?

Answer. The objective of the restructuring is to model the FHLBanks' boards of directors after the Federal Reserve System. A FHLBank's board of directors would consist of nine board members representing three different classifications: (1) three members of the savings industry; (2) three public members representing the housing industry; and (3) three public members (who cannot be from the savings industry) chosen by the Chairman of the FHLBS.

The plan provides for explicit representation by the housing industry to ensure that the concerns of the housing industry play a direct role in the policies and practices of these government-sponsored enterprises.

Question. The Technical and Miscellaneous Revenue Act of 1988 extended for six months (June 1989) favorable tax rules for financially troubled institutions. Without these rules, case resolutions would be more expensive. Does the Administration feel that these tax provisions should be made a part of the proposed bill? Should these provisions be extended further?

Answer. The Administration has not included the special rules in the bill and does not support extending them.

QUESTIONS SUBMITTED BY SENATOR BURDICK

RURAL ELECTRIFICATION ADMINISTRATION

Question. Have you issued the regulations to allow the repayment required by law of \$500 million worth of REA guaranteed FFB loans? Why were the regulations not issued October 1 since you knew the \$500 million would be allowed that day?

Answer. The Treasury Department does not issue the regulations governing the prepayment of the \$500 million in loans made by FFB to rural electric and telephone borrowers. Those regulations will be issued by the Agriculture Department. The Treasury Department does not know the reason why the regulations were not issued on October 1; the Treasury Department did not receive a copy of the proposed regulations for Executive Branch review and comment until November 30.

Question. When will they be issued?

Answer. The Treasury Department does not know precisely when the regulations will be issued by the Agriculture Department, but expects that the regulations will not be issued until resolution of an issue (discussed below) raised in the proposed regulations. This issue has been referred by the Agriculture Department and the Treasury Department to the Justice Department for resolution. The Treasury Department desires that the Justice Department provide a speedy resolution to this issue.

It is not the desire of the Treasury Department to be an impediment to the prepayment of the \$500 million authorized by law. It is important to understand that had the proposed regulations been substantially the same as the regulations implementing the previous prepayment legislation, modified simply to the extent necessary to provide for prepayments by rural telephone borrowers, there would have

been no issue to refer to the Justice Department and no delay in issuing regulations.

There are several borrowers who are able to prepay a portion of their loans without refinancing.

Question. Do you plan to allow such borrowers to prepay?

Answer. Rural electric and telephone borrowers will be allowed to prepay their FFB debt in accordance with the requirements in the law. The law authorizes the borrowers to prepay their FFB loans "if . . . private capital, with the existing loan guarantee, is used to replace the loan. . . ." Moreover, as stated in the background information provided with these questions, the intent of Congress was to allow borrowers to prepay at par and refinance while retaining the REA guarantee. Since it is unclear to the Treasury Department that borrowers seeking to prepay their FFB loans without using the existing REA guarantee are authorized to prepay at par or, put in other words, whether the Treasury Department is authorized to accept par prepayments from such borrowers in lieu of the full contractual value of such FFB loans, the Treasury Department has submitted the question to the Justice Department for its legal opinion.

Question. What will be the priority for borrowers to reach the \$500 million?

Answer. The Treasury Department does not set the priorities for refinancing and prepayment. However, it is likely that \$350 million will be allocated to rural electric borrowers and \$150 million will be allocated to rural telephone borrowers, as required by the 1989 Agriculture Appropriations Act.

The Treasury Department understands that the proposed Agriculture Department regulations will establish a priority giving preference to financially distressed borrowers and to borrowers prepaying their FFB loans without using the existing REA guarantee, thus exhausting the remaining prepayment authority available to rural electric borrowers. In effect, any rural electric borrower (other than a financially distressed borrower) that needs the existing REA guarantee to obtain financing to prepay its FFB loans will not be able to prepay its loans under the proposed regulations.

Question. What conditions will be imposed on borrowers to prepay?

Answer. The Treasury Department will not impose any conditions on borrowers beyond those conditions required by law. However, the Agriculture Department may impose conditions that the Treasury Department is not aware of.

It is interesting to note that each borrower that has prepaid its FFB loans to date has voluntarily agreed, as a condition of the refinancing loans, that all or part of such refinancing loans will not be prepayable for a certain time period (generally, ten years), and thereafter such refinancing loans will be prepayable only upon payment of a premium.

Question. Since prepayment has the effect of reducing outlays, do you propose any additional prepayments?

Answer. While prepayments produce increased receipts in the immediate budget year, they reduce receipts in future years, thus increasing the deficit in those years. Also, since par prepayment does not return to the Government the full value of the original lending by the Government, the FFB, and ultimately the taxpayer, suffers a loss on the lending. Therefore, as my predecessors have done, I will continue to oppose prepayment at other than the contractual value of the loan.

FARM CREDIT SYSTEM

Question. In 1989, \$175 million was appropriated to the Treasury for payments to the Farm Credit System Financial Assistance Corporation. However, your budget shows that you expect more than \$134 million of that money to lapse. Are you confident that your estimate of \$123 million for 1990 is in the ball park?

Answer. The Administration's estimate of \$123 million in appropriations for fiscal year 1990 for the Farm Credit System Assistance Corporation (FAC) is based upon the best information available to OMB and the Farm Credit System Assistance Board (Assistance Board) regarding future needs. There is certainly no reason to believe that more than this amount will be required.

Question. How much debt has been issued, and how much more do you expect to issue this year?

Answer. As of March 27, 1989, FAC has issued \$690 million in 15-year bonds. Treasury is not obligated to pay any interest on nearly \$260 million of these bonds. The Assistance Board has estimated that FAC will issue an additional \$1 billion in bonds in fiscal year 1989.

Question. What rate of interest are you having to pay on this debt?

Answer. Outstanding FAC bonds are priced at 32 to 37 basis points over comparable Treasury securities, to yield between 9.4 and 9.5 percent.

QUESTIONS SUBMITTED BY SENATOR ADAMS

Question. In conclusion Mr. Brady, I am quite aware that this is a national problem that demands national solutions, however, is it not true that there are regions in our country, who, under your proposal, will be penalized for the mistakes of others (e.g., increased insurance premiums)? How would you respond to the depositors, officers and board members of thrift institutions in my state?

Answer. Although it is certainly true that the Southwest has had a disproportionately large share of the S&L problem, the scope of the problem reaches beyond regional differences. For instance, even in your state of Washington, there have been three institutions merged or closed by FSLIC since August of 1988. More importantly, though, every single thrift institution has benefitted in the past, and will continue to benefit in the future, from Federal deposit insurance.

Deposit insurance is a public good not unlike a community's fire department, which is paid for by whole communities, not just those members who have fires. Individual members of the community support their fire department for insurance against the possibility of fire, but also because the whole community benefits when even one member's house is saved.

Each and every thrift institution will likewise benefit from the Administration's plan, which will restore public confidence in the industry, and restore the insurance fund to health. But for those who have committed fraud and otherwise abused the trust of the majority of the industry who are honest and competent, the Administration's plan provides some very stiff enforcement measures. In summary, we believe that the Administration's plan is one which the whole community of thrifts should be able to support.

QUESTIONS SUBMITTED BY SENATOR HATFIELD

ECONOMIC GROWTH RATE FOR 1989

Question. It is my understanding that the Administration's assumed economic growth rate for 1989 is 3.5 percent. The Administration's FY-1990 budget, however, states that "without the expected rebound from the drought, it [the 1989 growth rate] would be 2.8 percent measured on a fourth-quarter over fourth-quarter basis."

Because there is considerable question as to whether we really will rebound this year from last year's drought, is not the 3.5 percent growth rate overly optimistic?

Answer. Of course, we can never depend on the weather. Some parts of the country are still experiencing dry conditions. However, soil moisture levels have improved significantly in most parts of the country, and the odds strongly favor at least a normal crop year.

It should be noted that resumption of normal farm production is not a crucial element in the overall budget picture. Last year's drought resulted in higher prices for farm commodities and somewhat lower farm support payments to farmers than had been projected. Of course, prolonged distress in the farm economy could well imply the need for additional relief later on.

Question. How will the recent rise in the Federal Reserve's discount rate affect economic growth in the coming year?

Answer. The Federal Reserve has been pushing up short-term interest rates steadily over the past year. The recent increase in the discount rate largely ratified those earlier increases, in fact, still left the discount rate substantially below market rates of interest.

Federal Reserve moves to raise interest rates and slow growth of monetary aggregates came in response to stronger economic growth than had been anticipated and the fear that this would result in some build-up of inflationary pressures. Ideally, growth would come down to a rate consistent with no acceleration of inflation, or even some moderation. The Administration believes that the 2.8 percent rate of growth projected for this year (excluding the recovery from the drought) is consistent with that goal and would allow for some easing of inflation.

Because it acts with relatively long and sometimes variable lags, there is always the danger that monetary tightening will have a greater than desired impact. Some signs are emerging that the rate of growth of the economy is slowing. However, the economy still is carrying substantial forward momentum. On balance, a moderate

slowing to a sustainable rate of growth, as in the Administration forecast, appears to be the most likely outcome.

LONG-TERM INVESTMENTS

Question. As Secretary of the Treasury, you are largely concerned with the inflow of revenues—the cash flow, if you will—to the Federal Treasury. Unfortunately, in this age of Gramm-Rudman and record Federal deficits, the Federal Government seems to be preoccupied with the revenues and expenditures—the variables that determine whether we meet the Gramm-Rudman targets—for only the current year.

However, we also know that in order to ensure that the nation remains strong and competitive in the future, we must be willing to invest resources today that will have a “pay-back” at some later point in time (e.g., infrastructure improvements, reforestation of Federal forests, etc.).

Do you agree that we must be willing to make investments in the future—even if we will not see a return on these investments for many years?

If so, in what ways are you encouraging the Administration and Congress to be willing to make these investments? Will you propose any specific policies or initiatives?

If you do not agree, why not?

Answer. President Bush has stated repeatedly that his Administration is committed to making investments now that will lay the groundwork for continued American leadership in the 21st century. I agree wholeheartedly in this commitment.

In his agenda for building a better America, the President outlined a comprehensive program targeted at enhancing productivity, which is the key to long-term competitiveness and economic growth. This program emphasizes initiatives that are designed to increase investment over the longer term even though not all of these investments will have an immediate payoff. Included are direct investments in both physical and human resources such as outlays for water, power, and natural resource projects; major equipment for the space program, energy research, and transportation services; grants to state and local governments for physical investments in highways, sewage treatment plants, community development, airports, mass transit; conservation programs for the improvement of land; conduct of research and development across a broad range of program areas; and education, training and health programs.

Also, the President's program includes several key proposals that will encourage the private sector to step up their long-term investments and to focus on activities that will provide large returns in the future and strengthen our competitiveness and promote economic growth. These include reducing the capital gains tax rate; making the Research and Experimentation Tax Credit permanent; tax incentives for stimulating domestic oil production; decontrol of natural gas; and creating enterprise zones.

In summary, the President's program focuses our investments on those activities most likely to create growth in the years ahead. This is a wise course of action for the very reason that you noted in your question, namely that we must be willing to invest today in resources—physical and human—that will make it possible to produce more tomorrow. I endorse and support strongly this program, especially the reduction in the capital gains tax rate, and will be working over the next few months to encourage the Congress to enact the initiatives and outlays necessary to implement it.

QUESTIONS SUBMITTED BY SENATOR KASTEN

IMF AND THE ENVIRONMENT

Question. In promoting environmental protection in the developing world, our efforts have focused largely on the MDB's. The IMF has almost entirely escaped our criticisms. Do you believe we should pay more attention to the environmental policies of the IMF?

What specific action is the Treasury considering to promote environmental protection associated with IMF actions?

Answer. The IMF does not finance specific projects but rather addresses broad macroeconomic issues—monetary, fiscal, and exchange rate policies—affecting a country's balance of payments position. There does not appear to be clear linkage between the IMF's policies and environmental concerns. Thus, it would not be possible to extend U.S. standards for assessing environmental impacts to IMF policies. Moreover, an effort to do so could undermine the IMF's ability to promote the eco-

conomic reforms essential to dealing with the pressing debt problems in developing countries. This would compromise U.S. efforts to strengthen the international debt strategy and be harmful to important U.S. economic interests.

DEBT-FOR-NATURE SWAPS

Question. There has been some discussion of reforming the "Baker Plan" for debt relief. There is considerable speculation about that here on the Hill. My question is—what consideration is being given to "debt-for-nature or conservation exchanges" as part of any new plan?

Answer. The Treasury Department has been supportive of debt-for-nature swaps and I fully expect this support to continue. We have for example, helped to clarify U.S. tax treatment of such swaps. The Department continues to look into tax and accounting issues related to these swaps, and has sought to advance environmental action in the multilateral development banks.

ENVIRONMENTAL REFORMS

Question. Under Secretary Baker's leadership, the Treasury was very aggressive in pursuing environmental reforms at the MDB's. Can I count on your commitment to make this a top priority under your leadership?

Answer. Yes. Environmental reforms at the MDBs will be an important priority for me. We have an extensive legislative mandate in this area and every effort will be made to implement it. In my statement at the IMF/IBRD Annual Meetings last September, I emphasized the importance of environmental reform. I plan to follow up at a meeting of the World Bank's Development Committee next month, urging that environmental issues be highlighted in the communique and placed on the agenda for the September meeting. On March 1, I wrote a letter to World Bank President Conable recommending that environmental information on specific projects be made available publicly in advance of board consideration of World Bank projects and that Board documentation on environmental analyses be made available after Board action. I am particularly concerned that we make more progress in this area and in encouraging the multilateral developments banks to develop appropriate internal environmental impact assessment procedures and in promoting such improvements in the borrowing countries themselves.

Question. There has been some discussion of reforming the "Baker Plan" for debt relief. There is considerable speculation about that here on the Hill. My question is what consideration is being given to "debt for nature or conservation" exchanges as part of any new plan?

Answer. Debt for nature or conservation exchanges would be entirely consistent with the various approaches we are now considering. We are, in fact, looking for opportunities to incorporate these types of exchanges into our activities. Last year, you may remember that an internal revenue ruling was made specifically to encourage debt for nature and debt for charity swaps.

Question. Two years ago the Treasury filed a report on a potential World Bank pilot program to promote conservation exchanges. What action has been taken to follow up on this report?

Answer. The report to which you refer was filed in April of last year. We will be meeting shortly with World Bank staff to follow up on the recommendations in the report.

Question. What is the Treasury doing to make energy conservation and improved efficiency a priority in each MDB portfolio?

Answer. Energy efficiency and conservation are major issues for us this year. We have advised all the MDBs of our interest in emphasizing these issues. The banks, themselves, have been encouraging the adoption of more realistic tariff schedules and the rehabilitation of transmission and distribution systems. The World Bank also indicates that it has begun energy-related preinvestment activities in more than 50 countries. These activities include both energy investment priorities on the supply side and energy efficiency assessments on the demand side.

Treasury has formed an informal working group, including participation from other government agencies and interested private sector organizations, to consider what specific measures we might take to encourage greater attention to energy conservation and efficiency measures. Thus far, the informal working group has held two meetings, the first in November 1988, and the second in February 1989.

Question. In the Foreign Operations Report last year, we included very strong language on the environmental problems associated with the Carajas loan. My staff has been working closely with you on implementing this provision. What is the status of

a formal determination of compliance with the environmental provisions of this loan?

Answer. As you indicate, Treasury staff have worked closely with your staff on this issue. At this point, World Bank management's position is that neither the borrower nor the guarantor have been out of compliance with the relevant provisions of the loan contract. Treasury's General Counsel's office is making a thorough review of this question and has not yet submitted their final determination as to whether or not the borrower or guarantor is out of compliance.

Question. In the summer of 1987, the U.S. stood alone and voted against the Brazilian Electric Power Sector Loan. We opposed this loan on environmental grounds—a first for any sponsored nation. Now a second loan is being reviewed by Bank staff. Barber Conable indicated to me this loan may be dropped before it even comes to the Board for consideration. If this loan, however, does come before the Board, is the U.S. prepared to conduct a similar review, and if necessary, oppose the loan?

Will we solicit the support of other voting members if the U.S. determines there are unacceptable consequences of this loan?

Answer. The Treasury Department has been monitoring the appraisal of this particular loan very closely over the past eighteen months. We have had a number of environmental and economic concerns about the loan and have met with Bank staff on several occasions. Our specific concerns have ranged from the land rights of indigenous Indians to energy efficiency and conservation measures and the implementation of provisions from previously-agreed loans. We have already discussed these concerns with other voting members of the Bank and solicited their views.

We are fully prepared to conduct a thorough review. Any decision on opposing the loan would depend on whether or not the loan actually comes to the Board and on the outcome of our review. A decision to solicit support for our position from other member countries would also depend on those circumstances.

QUESTIONS SUBMITTED BY SENATOR DOMENICI

SAVINGS AND LOAN PLAN: BUDGETARY TREATMENT

Question. Under the President's savings and loan plan, \$50 billion would be raised by a corporation known as REFCORP. The expenditure of these funds does not increase the deficit because of the off-budget status of REFCORP.

Last week, however, the acting director of CBO testified that REFCORP should be included in the budget. Between 1989 and 1999, this would increase outlays on a net basis by \$44 billion over Administration estimates. What is your reaction to the CBO position?

Answer. REFCORP is clearly not a government agency. REFCORP will be owned by the FHLBanks, just as FICO is. We believe this industry ownership ensures the significant industry "self-help" contributions that are so important to the Administration's proposal. If the Treasury were to issue the bonds directly, it would be directly responsible for both the interest and the principal on the borrowing. It would thus be extremely difficult to obtain industry help toward the interest I costs, particularly since no other industry pays Treasury debt service costs.

The principal of the REFCORP bonds will not be on-budget because it will be paid entirely with industry funds. Industry funds will purchase zero-coupon Treasury securities that will pay off the principal of the REFCORP bonds at maturity. There is thus absolutely no reason to put these bonds, which are not Treasury obligations and are not guaranteed by the Treasury, on-budget.

Treasury funds, along with the FHLBanks' earnings and FSLIC/RTC receivership proceeds, will go to pay interest costs on the REFCORP bonds. Treasury guarantees the payment of any shortfall, and every dollar of Treasury funds expended is scored on budget in the year expended.

SAVINGS AND LOAN PLAN: OFF-BUDGET SOLUTION

Question. One argument in favor of the President's savings and loan plan is that it would avoid the precedent of creating an exemption of G-R-H. Shouldn't we also be concerned about perpetuating the precedent of off-budget solutions to government problems?

Answer. We should certainly be concerned about off-budget solutions. That is why REFCORP has been specifically designed to address the S&L situation, and cannot easily be replicated for other funding needs. By requiring the industry to fund the principal on the REFCORP bonds, the REFCORP mechanism obtains up front a sig-

nificant industry contribution of \$6 billion. In addition, the REFCORP financing mechanism requires separate and distinct accounting for all costs associated with the Administration's plan.

In contrast with direct Treasury funding out of general revenues, this mechanism more easily accommodates an oversight function charged with ensuring accountability. To the extent that the REFCORP would set a precedent, the Administration believes that it would be a precedent of fiscal responsibility: It would send a message to the financial markets and the world that the Administration and Congress are serious about reducing the budget deficit.

Treasury will not support any exemption to Gramm-Rudman-Hollings. A G-R-H exemption would send a message to the financial markets that Congress is not serious about staying with G-R-H guidelines, thus causing an increase in the cost of all Treasury financing. A 10 basis point increase in Treasury costs on the public debt would result in a \$2.7 billion a year increase in debt financing costs.

SAVINGS AND LOAN PLAN: APPROPRIATIONS REQUIRED

Question. The Administration estimates that outlays for savings and loan insurance activities will total \$59.9 billion over ten years: \$37.9 billion for the insurance funds and \$22 billion for interest. Does this represent the total expected appropriations for savings and loan insurance activities?

Answer. We estimate that total appropriations needed for the Administration's plan between 1989 and 1999 will be \$76.8 billion.

Total net budget outlays, however, will be only \$39.9 billion, largely because of the nearly \$20 billion in additional bank premium collections, as well as normal budget scoring procedures for \$19.2 billion in FSLIC notes.

IRS INITIATIVES

Question. The Bush budget shows a similar increase in revenues due to an IRS initiative. Does the Bush budget propose the same increase in budget authority for IRS?

Answer. There is no change in the detail of the IRS request as proposed in the Bush budget. However, with the exception of about \$56 million in drug enforcement resources, the entire IRS budget is included in the flexible freeze category and subject to negotiation with the Congress. It is our position, however, that the revenue initiatives in the IRS request are required in order to generate the \$317 million in additional revenue. For this reason, we assign them a high priority in any negotiations.

Question. I understand that one of the President's priorities is an IRS drug initiative totaling \$56 million in fiscal year 1990. Is this amount included in the \$289 million increase in the Reagan budget?

Answer. The \$56 million in resources for drug enforcement is a level of effort already in the IRS budget, and expected to be repeated in fiscal year 1990. As such, it is not a part of the requested \$289.1 million requested increase. The separate status of the \$56 million has to do with its exclusion from the flexible freeze category, and therefore not proposed for negotiation.

Question. For what specific purpose will the proposed increase for an IRS drug initiative be used?

Answer. Even though the \$56 million in IRS drug enforcement resources are not part of a proposed initiative, those funds primarily will be used for financial analysis in support of money laundering enforcement, for the cost of processing currency transaction reports, and for investigating other aspects of financing drug trafficking that violate the criminal provisions of the tax code.

CAPITAL GAINS PROPOSAL

Question. Opponents of the Administration's capital gains proposal have criticized it as a change in tax policy that benefits only the wealthy income class. Has OMB or Treasury prepared any distributional analyses that answer some of these criticisms? How do you answer the charges that President Bush's capital gains proposal is another tax break for the rich?

Answer. The Treasury Department believes that the proposed lower capital gains tax rate will have positive effects on national economic growth. Improved national economic growth will benefit all Americans. We believe it is also consistent with distributional fairness.

Our estimates show that the President's proposal to lower the capital gain rate will generate more tax revenue from wealthy taxpayers while reducing capital gains

taxes paid by lower income families. If tax changes resulting from induced realizations are taken into account along with static changes in tax, the restoration of a capital gains tax rate differential results in a slightly progressive redistribution of taxes. For example, as shown in Table I, before making adjustments for conversion and targeting, under the basic proposal there would be a 9.2 percent increase in tax for all taxpayers with over \$50,000 of adjusted gross income and a 3.1 percent reduction in capital gains tax for taxpayers with less than \$50,000 of income.

Most analysts who charge that the lower capital gains rate benefits principally the rich only show the static distribution of the tax change without including the additional taxes paid on increased realizations. Taking into account the increased taxes from increased realizations shows higher income taxpayers paying more, not less, capital gains taxes. Economic studies of the behavioral reactions of individuals to changes in capital gains tax rates suggest that higher income taxpayers are more responsive than lower income taxpayers to tax rate changes, and thus will be more likely to pay more total capital gain taxes due to large increases in realizations.

Although a large percentage of capital gains is realized by high income taxpayers, most taxpayers who would benefit from the Administration's proposal have low and moderate incomes. In 1985, the latest year for which detailed tax return data have been analyzed, as shown in Table 2, one-third of all tax returns with long-term capital gains reported other (noncapital gain) income of less than \$20,000. Nearly three-fourths of all tax returns with capital gains had other income of \$200,000 or more. The Administration's proposal for a 100 percent exclusion for lower income taxpayers will provide many current capital gain realizers with a significant tax reduction.

Table 1

**Distribution of Net Capital Gains, and Tax Liability
Under Current Law and an Across the Board Rate Cut 1/
(Calendar Year 1991, \$Billions)**

Adjusted Gross Income Class Under Current Law	Capital Gain Realizations		Tax on Capital Gains	
	Current Law	Rate Cut 1/	Current Law	Rate Cut 1/
Less Than \$10,000	19	22	0.9	0.7
\$10,000 to \$19,999	7	10	0.9	0.7
\$20,000 to \$29,999	8	12	1.3	1.2
\$30,000 to \$49,999	15	29	3.3	3.6
\$50,000 to \$99,999	24	54	6.3	7.5
\$100,000 to \$199,999	23	50	6.4	6.9
\$200,000 or more	86	172	22.2	23.7
TOTAL	182	349	41.3	44.3
Department of the Treasury Office of Tax Analysis			March 14, 1989	

1/ The estimate assumes a 45% exclusion, 15% maximum rate on capital gains. This does not include the effect of a limitation to non-depreciable assets, a three year holding period, or a 100% exclusion for low income families.

Table 2

**Distribution of Net Long Term Capital Gains
For Returns With Long Term Capital Gains in 1985**
(In Percent)

Adjusted Gross Income Class Without Capital Gains	Distribution of Returns With Long Term Gains	Distribution of Long Term Gains	Percentage of Total Returns With Long Term Gains
Less than \$10,000	16.9%	19.7%	5.1%
\$10,000 to \$19,999	16.5	5.9	6.5
\$20,000 to \$29,999	15.9	6.1	9.8
\$30,000 to \$49,999	24.7	12.0	13.6
\$50,000 to \$99,999	19.7	17.5	24.6
\$100,000 to \$199,999	4.5	12.6	56.2
\$200,000 or more	1.8	26.2	76.1
TOTAL	100.0%	100.0%	9.9%

March 14, 1989

Department of the Treasury
Office of Tax Analysis

Source: 1985 IRS Statistics of Income

CHILD CARE TAX CREDITS

Question. When do you intend to transmit legislation implementing the proposal outlined in the Bush Budget (Building a Better America)?

Answer. On March 15, 1989, the President submitted to Congress the legislation needed to implement the child care tax proposals outlined in the budget. Under the "Working Family Child Care Assistance Act of 1989," low-income families with children under the age of four would be entitled to a refundable credit of up to \$1,000 per child. In addition, the existing child and dependent care credit would be made refundable.

Question. Would you please provide a breakout of your revenue loss estimates by the two major components of your proposal: the new toddler credit and making the current dependent care credit refundable?

Answer.

(In millions of dollars)

	Fiscal year—				
	1990	1991	1992	1993	1994
New child credit.....	-141	-1,446	-1,774	-2,053	-2,420
Make dependent care credit refundable	-45	-447	-437	-429	-410
Total	-187	-1,893	-2,211	-2,482	-2,830

EXPLANATORY NOTE: The estimate, shown above, for making the dependent care credit refundable is "stacked last"; that is, this estimate assumes implementation of the new child credit and reflects the likely interactions between the two credits. Note, in particular, that under the Administration's proposal, families will not be able to take both credits with respect to the same child and that many low-income families will find the new child credit the more advantageous of the two credits.—Office of Tax Policy, March 27, 1989.

Question. What are the total collections and disbursements, as well as net outlays, of the Administration's plan for resolving the S&L crisis?

Answer: Attached is a funding summary that accompanied the Secretary's testimony before the Senate and House Banking Committees. As you can see, we have estimated that total FSLIC/RTC disbursements will be \$126.2 billion between 1989 and 1999, while collections will be \$88.3 billion. FSLIC/RTC net outlays are thus \$37.9 billion during this period. However, after including our estimates of Treasury payments for the interest on REFCORP bonds, as well as additional FDIC collections from raising bank premiums, we have estimated that total budget outlays will be \$39.9 billion between 1989 and 1999.

FUNDING SUMMARY
(\$ in billions)

2/20/89	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94	89-94	89-99
FSLIC/RTC Disbursements	27.7	31.2	22.5	7.8	8.3	5.8	103.2	126.2
Old Cases & Other Expenses	17.7	6.2	5.5	5.4	4.7	3.8	43.2	52.2
New Cases	10.0	25.0	17.0	2.4	3.6	2.0	60.0	74.0
Collections (-)	-17.0	-29.8	-16.5	-3.2	-3.6	-3.5	-73.5	-88.3
New FICO(REFCORP) Bonds	-10.0	-25.0	-15.0	-1.5	-1.5	-2.0	-50.0	-50.0
Old Premiums (Net)	-1.4	0.4	0.3	-0.3	-0.3	0.4	-5.6	-19.0
Additional Premium 1/	-5.6	-5.2	-1.6	-1.4	-1.8	-1.9	-17.5	-21.4
Other Old Collections								
FSLIC/RTC Net Outlays	10.7	1.4	6.0	4.6	4.7	2.3	29.7	37.9
Treasury Payments for Bond (REFCORP) Interest	0.5	1.4	1.6	0.9	0.8	1.1	6.3	22.0
Add'l FDIC Collections	0.0	-0.8	-1.6	-1.7	-1.8	-1.9	-7.9	-19.9
TOTAL BUDGET OUTLAYS	11.1	1.9	6.0	3.8	3.7	1.5	28.1	39.9

1/ A (-) indicates increase in premiums, a (+) indicates a decrease.

2/20/89 Assumptions	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94
FICO (CEBA) Rates	9.8%	8.6%			wtd avg (88-90):	9.5%
REFCORP Rates	9.1%	7.9%	6.5%		wtd avg (89-91):	7.7%
Int Rate on LT Treasuries	8.8%	7.6%	6.2%		wtd avg (89-91):	7.4%
Discount on zeros	8.8%	7.6%	6.2%		wtd avg (89-91):	7.4%
Int Rate on FSLIC Notes	9.5%	7.8%	6.1%	4.9%	4.3%	4.0%
FSLIC Deposit Base (\$ in trillions)	1.0	1.1	1.2	1.2	1.3	1.4
1989-99 Growth Rate	7.2%					
FDIC Deposit Base (\$ in trillions)	2.1	2.3	2.4	2.6	2.8	2.9
1989-99 Growth Rate	6.9%					

Recovery on receivership assets (new cases):

40 cents on each dollar over the 4 years subsequent to liquidation

Question. What do you estimate the interest rates on the REFCORP bonds will be?

Answer: We have attached a summary of our plan's assumptions from the Secretary's testimony before the Banking Committees. As a starting point, we have used the Administration's estimates for comparable long-term Treasury bonds. We have also estimated that the yield on REFCORP bonds will be about 25 basis points over that of comparable Treasury bonds. Thus, our estimates for the interest rates on REFCORP bonds (which are fixed rate instruments) in the 3 years they will be issued average 7.7 percent.

Question. What additional collections will the FDIC receive as a result of the increase in deposit insurance premiums on insured banks?

Answer: We have estimated that the increased premiums on banks will result in additional FDIC collections of \$19.9 billion between 1989 and 1999. These additional funds will be used to rebuild the insurance fund for banks to its historically safe level. Not one penny of premium income from commercial banks will be used in resolving the S&L problem. However, because both insurance funds are on budget, these increased premiums do decrease the total budget outlays of our plan.

Question. How much of the interest costs on REFCORP bonds will be paid by the industry, and how much will be paid by Treasury?

Answer: We estimate that the total interest costs on the REFCORP bonds over thirty years will be \$115.1 billion. Of this amount, we estimate that the industry will pay \$21 billion, and that the Treasury will pay the rest.

SUBCOMMITTEE RECESS

The CHAIRMAN. Thank you very much for your attendance, and the hearing is recessed.

[Whereupon, at 1:50 p.m. Tuesday, March 7, the committee was recessed to reconvene subject to the call of the Chair.]

BUDGET OVERVIEW FOR FISCAL YEAR 1990

THURSDAY, MARCH 9, 1989

U.S. SENATE,
COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The committee met at 10 a.m. in room SD-192, Dirksen Senate Office Building, Hon. Robert C. Byrd (chairman) presiding.

Present: Senators Byrd, Bumpers, Harkin, Adams, Fowler, Kerry, Stevens, Cochran, Kasten, Domenici, Grassley, and Nickles.

CONGRESSIONAL BUDGET OFFICE

STATEMENT OF ROBERT D. REISCHAUER, DIRECTOR

ACCOMPANIED BY JAMES BLUM

OPENING REMARKS OF SENATOR BYRD

The CHAIRMAN. Today, the committee will receive the testimony of the Director of the Congressional Budget Office, Dr. Robert Reischauer. I was pleased to join Speaker Wright in appointing Dr. Reischauer as CBO Director effective March 6.

Dr. Reischauer, you have an excellent background, both at CBO and elsewhere that should enable you to meet your new responsibilities effectively. You also have a fine group of professionals to assist you, not the least of whom is Jim Blum. Mr. Blum has served admirably as CBO's Acting Director for some time and has been very helpful to this committee.

We received the testimony of Treasury Secretary Brady earlier this week. The main focus of that hearing was the President's proposal to deal with the savings and loan crisis. I know that CBO has done an extensive analysis of this proposal and we will discuss your findings today.

Finally, we should have your latest views on the differences between CBO's economic forecasts and those of the administration. There are large differences in the fiscal year 1990 deficit projections as well as those of the following 4 years between CBO and OMB.

I understand that the ranking member, Senator Hatfield, has gone to the swearing in of Arthur Watkins this morning and will be a little late in arriving. I am happy to see my good friend Senator Stevens of Alaska here.

Senator Stevens, I have made a very, very brief opening statement, and would you have anything you would like to say at the opening?

Senator STEVENS. No, Mr. Chairman. I feel that Senator Hatfield may have a statement for the record, and we might reserve a place in the record for his statement, but I did not have one for this morning.

The CHAIRMAN. All right.

Dr. Reischauer, we look forward to receiving your statement.

Dr. REISCHAUER. Thank you, Mr. Chairman, for your kind words of welcome. I would like to take this opportunity to publicly thank you as well as two members of this committee, Senator Sasser and Senator Domenici, for providing me with an opportunity to return to Capitol Hill and to be a part of the congressional budget process once again.

I am accompanied by Jim Blum, who has been the Acting Director of the Congressional Budget Office and done an extremely good job over the last year. He has been in charge of our analysis of the thrift industry and he can help me with questions in that area.

With your permission, I will submit my prepared statement for the record and briefly summarize the highlights of that statement for you here today.

The CHAIRMAN. Very well.

DIFFERENCES BETWEEN CBO'S AND ADMINISTRATION'S DEFICIT ESTIMATES

Dr. REISCHAUER. Let me go directly to the main issue. CBO reestimates of the administration's budget suggest that the administration has understated the size of the deficits that are likely to result from its proposals. The magnitude of these underestimates depends crucially on the budgetary treatment of the Resolution Financing Corporation [REFCORP] which is the mechanism under which the administration proposes to deal with the crisis in the savings and loan industry.

If REFCORP is treated as an on-budget agency, as CBO thinks is most appropriate, the fiscal year 1990 deficit that results from the administration's proposals will be \$131 billion, \$40 billion higher than the \$91 billion figure provided by the administration. These numbers are laid out on page 2 of my statement.

If assets sales and REFCORP are excluded from the budget totals, CBO estimates that the administration's policies would result in a deficit of \$109 billion, which is \$1 billion below the sequestration threshold contained in the Gramm-Rudman-Hollings legislation, but still \$18 billion larger than the administration projects.

CBO's deficit estimates and those of the administration diverge not only over the budgetary treatment of REFCORP, but also because we use different economic and different technical assumptions. Divergent economic assumptions account for \$9 billion of the gap between the administration and CBO's estimates of the deficit in 1990 and \$78 billion of the difference between our estimates in 1993.

CBO forecasts that over the next 5 years, economic growth will be significantly slower and inflation and interest rates significantly higher than the administration expects. CBO expects that economic growth will proceed at a pace of 2 to 2½ percent rather than 3 or

more percent, as anticipated by the administration, because we believe that the Federal Reserve will try to hold the growth of the economy to a pace that is consistent with the expansion of the Nation's economic potential. CBO and the Federal Reserve believe that the economy's productive capacity or its potential is expanding at around 2½ percent a year.

Different technical assumptions account for \$8 billion of the gap between the administration's and CBO's estimates of the fiscal year 1990 deficit. The major technical differences are laid out on page 12 of my statement. For example, CBO expects that the administration's proposal for leasing the Arctic National Wildlife Refuge and its proposal to auction off certain unassigned spectrum frequencies will generate around \$4 billion less in fiscal year 1990 than the administration anticipates.

CBO also expects defense outlays in fiscal year 1990 to exceed the administration's figures by about \$3.5 billion to \$4 billion and Federal Deposit Insurance Corporation outlays to be about \$3 billion higher than the administration expects.

On the revenue side, CBO expects that receipts generated from the current tax law will be about \$9 billion higher than the administration projects for fiscal year 1990. Of this gap, \$4 billion arises from different economic assumptions and \$5 billion from different technical estimating procedures. But over the fiscal years 1991-93 period, CBO and the administration have very similar estimates of the revenues that are likely to be generated from current tax law.

We differ substantially, however, on the probable revenue impact of the administration's proposal to reduce the tax on capital gains. CBO, as well as the Joint Committee on Taxation, judge that after an initial surge in fiscal year 1990, increased realizations of capital gains will not be sufficient to offset the effects of reduced tax rates and, therefore, there will be a \$4 billion revenue loss in fiscal year 1991 that will grow to about \$7 billion in fiscal year 1993.

Since the administration has projected a \$5 billion revenue gain from its capital gains tax proposals in fiscal year 1991, there is a \$9 billion gap for that year between CBO and OMB's estimates of this issue.

COMPARING ADMINISTRATION'S BUDGET WITH CBO PROJECTIONS

Comparing the administration's budget proposals with the CBO baseline projections will highlight the policy changes that are being proposed without the confusion often caused by the use of different economic and technical assumptions. The details of this analysis are laid out on page 18 of my statement. First, under the administration's proposal, national defense outlays will be slightly above the CBO baseline amounts in fiscal year 1990 but below our expectations for the baseline during the fiscal year 1991 to 1993 period. This shortfall in the out-years results from CBO's higher expectations about inflation.

Second, spending on numerous nondefense discretionary accounts in which the administration has made specific recommendations will be \$1 billion over the baseline level in fiscal year 1990, a figure that should grow to about \$3 billion by 1993. The fiscal year 1990

estimate is a net figure, a difference between \$3.8 billion in proposed increases and \$2.5 billion of decreases.

Third, under the administration's budget, outlays for entitlements and other mandatory spending programs in fiscal year 1990 will exceed CBO's baseline by about \$1 billion. This estimate is also a net figure. There would be \$12 billion of reductions in such programs as Medicare, farm price supports, and Federal retirement benefits that would be balanced against increases of around \$12.8 billion in deposit insurance accounts.

Fourth, the administration has proposed a reduction of about \$9 billion below the CBO baseline in the spending for a residual category of domestic programs. The administration hasn't spelled out the specific cuts for this set of programs but has stated that outlays from them will not exceed fiscal year 1989 levels. The estimates that we have provided this committee assume that this goal is achieved.

COMPARING ADMINISTRATION'S PROPOSED CUTS WITH ALTERNATIVES

Finally, the last table in my statement looks at the spending programs that are within the jurisdiction of the committee and compares the administration's proposal with three alternatives: the CBO baseline, a resource freeze that would hold discretionary spending authority at the 1989 fiscal year levels, and the Reagan budget proposal.

The budget authority and outlay effects of this are broken into three categories: mandatory spending, discretionary defense spending, and nondefense discretionary spending. These numbers are laid out on page 22 of my statement.

The administration's proposal will reduce the mandatory category relative to both the CBO baseline and a resource freeze, but it represents an increase in mandatory spending over the levels proposed by the Reagan budget.

In the discretionary defense category, the administration's proposal for budget authority is identical to the CBO baseline. In the nondefense discretionary accounts, the administration is suggesting a \$7 billion reduction in budget authority from a baseline figure which is very close to what would result from a resource freeze.

The Congressional Budget Office looks forward to assisting this committee in its work on the fiscal year 1990 budget. As new information about the administration's budget becomes available over the weeks and months ahead, we will inform your staff of the impact that this has on the analysis that we have prepared for you.

Thank you.

[The statement follows:]

STATEMENT OF ROBERT D. REISCHAUER

Mr. Chairman, I am pleased to appear before the Committee this morning to discuss President Bush's budget recommendations. In February, at the request of this Committee, the Congressional Budget Office (CBO) prepared *An Analysis of President Reagan's Budgetary Proposals for Fiscal Year 1990*. Because the Bush budget proposals are largely the same as those in the Reagan budget, most of the analysis in CBO's earlier report remains relevant.

CBO finds that the Administration has understated the deficits that would result from adopting its proposed policies. The size of this gap depends on the budgetary treatment of the proposed savings and loan Resolution Financing Corporation (REFCORP). The Administration proposes that REFCORP be an off-budget government sponsored enterprise. CBO believes, however, that REFCORP has all the earmarks of a government entity and should be included in the budget totals.

The Administration estimates that the federal deficit would decline from \$163 billion in 1989 to \$91 billion in 1990. Including REFCORP in the budget, however, would increase the estimated 1990 deficit by \$22 billion, as shown in Table 1. Incorporating CBO's assumptions of lower economic growth and higher interest rates would add another \$9 billion to the deficit estimate. CBO also believes that the Administration's use of technical estimating assumptions has

understated the deficit by \$8 billion. Taking into account all of these factors, CBO estimates that the 1990 deficit would be \$131 billion if all of the Administration's proposals were adopted.

TABLE 1. CBO AND ADMINISTRATION ESTIMATES OF THE BUDGET DEFICIT UNDER BUSH ADMINISTRATION POLICIES (By fiscal year, in billions of dollars)

	1989	1990	1991	1992	1993
Administration Estimate, Including Asset Sales	163	91	62	27	-4
CBO Reestimates					
Economic differences	-4	9	33	55	78
Technical differences	-2	8	17	22	22
REFCORP ^a	<u>9</u>	<u>22</u>	<u>12</u>	<u>b</u>	<u>b</u>
Subtotal	3	40	62	77	100
CBO Estimate, Including Asset Sales and REFCORP	166	131	124	104	97
Adjustments					
Asset sales	5	3	2	1	-1
REFCORP	<u>-10</u>	<u>-25</u>	<u>-15</u>	<u>0</u>	<u>0</u>
Subtotal	-5	-22	-13	1	-1
CBO Estimate, Excluding Asset Sales and REFCORP	161	109	111	105	96
Balanced Budget Act Targets	136	100	64	28	0

SOURCES: Office of Management and Budget; Congressional Budget Office.

NOTE: The totals include Social Security, which is off-budget.

a. The proposed Resolution Financing Corporation (REFCORP) would borrow money in private credit markets to assist in resolving troubled savings and loan institutions.

b. Less than \$0.5 billion.

One can make a good case, however, that the spending made possible by REFCORP borrowing can be distinguished from most government spending and should not be counted under the Balanced Budget Act. Excluding these expenditures for resolving the savings and loan crisis from the deficit calculations would be consistent with the way asset sales are already treated under the act. Excluding both asset sales and REFCORP, CBO estimates that President Bush's proposals would result in a 1990 deficit of \$109 billion--only \$9 billion above the Balanced Budget Act target of \$100 billion.

CBO ECONOMIC ASSUMPTIONS

CBO estimates that the long-run growth rate of the economy's productive capacity is about $2\frac{1}{2}$ percent a year. In the aftermath of a recession, when much capacity is unused, the economy can easily grow more rapidly than this trend. But when almost all of the economy's capacity is being used, as is the case after six years of expansion, such growth is not possible. If the economy were to continue growing at its recent rapid rate, inflation would probably increase. The Federal Reserve has therefore sought to slow economic growth to a pace that is sustainable over the long haul.

Forecast for 1989 and 1990

CBO's short-term economic forecast is shown in Table 2. The forecast assumes that the Federal Reserve will be successful in holding the economy's growth to a rate that will avoid a sharp increase in inflation, and that the 1990 deficit will be reduced to satisfy the Balanced Budget Act's requirements.

The growth rate of real gross national product, which was 2.7 percent in 1988, is expected to rise to 2.9 percent in 1989 and drop back to 2.2 percent in 1990. Excluding the farm sector, which was hard hit by last summer's drought, the growth rate declines from 3.5 percent in 1988 to 2.1 percent in 1989 and 2.2 percent in 1990. Unemployment should remain near its current level of about 5½ percent. Net exports and business fixed investment are expected to be the major sources of economic expansion in the next two years. Because of the strength of the dollar in mid-1988 and early 1989, however, the rate of improvement in real net exports is likely to be slower in 1989 and 1990 than it was in 1988.

CBO projects that increases in the prices of food and imports will push consumer price inflation up from 4.3 percent in 1988 to 5.0 percent in 1989. Because wage growth is likely to accelerate, inflation

TABLE 2. COMPARISON OF ADMINISTRATION, CBO, AND BLUE CHIP SHORT-RUN ECONOMIC FORECASTS

	<u>Actual</u> 1988	<u>Forecast</u>	
		1989	1990
Fourth Quarter to Fourth Quarter (Percent change)			
Real GNP			
Administration	2.6	3.5	3.4
CBO	2.6	2.9	2.2
Blue Chip	2.7	2.4	1.8
Nominal GNP			
Administration	6.8	7.3	7.0
CBO	6.7	6.9	6.6
Blue Chip	6.9	6.8	6.2
Consumer Price Index ^a			
Administration	4.2	3.6	3.5
CBO	4.3	5.0	4.8
Blue Chip	4.2	4.7	4.7
Calendar Year Averages (Percent)			
Three-Month Treasury Bill Rate			
Administration	6.7	7.4	5.5
CBO	6.7	7.9	7.1
Blue Chip	6.7	8.1	7.5
Ten-Year Government Bond Rate			
Administration	8.9	8.6	7.2
CBO	8.9	9.3	9.0
Blue Chip ^b	8.9	8.9	8.5
Civilian Unemployment Rate			
Administration ^c	5.4	5.2	5.1
CBO	5.5	5.5	5.5
Blue Chip ^b	5.5	5.4	5.6

SOURCES: Congressional Budget Office, Office of Management and Budget; Eggert Economic Enterprises, Inc., *Blue Chip Economic Indicators* (February 10, 1989).

- a. Consumer Price Index for urban wage earners and clerical workers.
- b. *Blue Chip* does not project a ten-year note rate. The values shown here are based on the *Blue Chip* projection of the AAA bond rate, adjusted by CBO to reflect the estimates spread between AAA bonds and ten-year government notes.
- c. The Administration's projection is for the total labor force, including armed forces residing in the United States, while the CBO and *Blue Chip* projections are for the civilian labor force excluding armed forces. In recent years, the unemployment rate for the former has tended to be 0.1 to 0.2 percentage points below the rate for the civilian labor force alone.

is not expected to subside much in 1990. Interest rates are projected to remain high in the first half of 1989, as monetary restraint continues. Rates are forecast to ease somewhat later in 1989 and in 1990, reflecting the expectation that the central bank will be successful in its effort to hold growth within the 2 percent to 2½ percent range.

Uncertainty in the Forecast

CBO's short-run forecast represents only one of the possible paths that the economy might take over the next two years. We believe, however, that the forecast lies roughly in the middle of the possible outcomes and is a prudent guide to budgetary planning. It is also close to the average of the 50 private-sector forecasts summarized in the *Blue Chip Economic Indicators*, as shown in Table 2.

Most forecasters agree that the Federal Reserve's effort to control inflation is the key source of uncertainty in the economy today. Even under the best of circumstances, it is difficult for monetary policy to slow the economy gradually. The economy may continue to grow rapidly in spite of monetary tightening, thereby provoking higher inflation, further tightening, a rapid increase in interest rates, and eventually a recession. Today, the Federal Reserve's task is also complicated by the volatility of the dollar, the shaky condition of a

number of thrift institutions and banks, the debt problems of developing countries, and the high degree of corporate financial leveraging. Although CBO forecasts a smooth slowing of growth through 1989, a number of private forecasters expect a recession to begin this year.

The Bush Administration's forecast is considerably more optimistic than CBO on the outlook for inflation and economic growth. The Administration forecasts fourth-quarter-to-fourth-quarter growth rates that exceed CBO's by 0.6 percentage point in 1989 and 1.2 percentage points in 1990 (see Table 2). Inflation is more than a percentage point lower than CBO projects. Interest rates are about one-half of a percentage point lower in 1989 and about one and one-half percentage points lower in 1990. This more favorable outlook assumes that the potential for noninflationary growth is greater than estimated by CBO. The Administration projects that productivity will grow about 2 percent a year. While this is near the post-World War II average, the growth of productivity since mid-1981 has been only 1.4 percent a year. The CBO forecast assumes that growth of productivity will continue at the slower recent rate.

Projections for 1991 through 1993

For 1991 through 1993, CBO's economic assumptions are not a forecast of future conditions but are projections based on past trends. As shown in Table 3, CBO projects that real GNP will grow at an average annual rate of 2.2 percent, and that the unemployment rate will remain close to current levels. Consumer price inflation is projected to decline moderately after 1990 and stabilize around 4 percent. Interest rates are projected to decline throughout the period until they reach levels near the average of inflation-adjusted interest rates since 1973. In 1993, the three-month Treasury bill rate is assumed to be 6.1 percent, and the ten-year government note rate is projected to be 7.7 percent.

The Administration's long-run assumptions, on the other hand, are substantially more optimistic than seems likely based on recent experience. The Administration assumes that unemployment during the 1991-1993 period will remain at 5 percent and that the economy will achieve an average growth rate of 3.2 percent a year. The Administration projects that inflation will fall to 2.2 percent in 1993, even though the economy is assumed to grow rapidly. Short-term interest rates are projected to drop to 3.5 percent in 1993 and long-term rates to 4.5 percent.

TABLE 3. COMPARISON OF ADMINISTRATION AND CBO
ECONOMIC ASSUMPTIONS, 1989-1993 (By calendar year)

Variable	Actual	Forecast		Projected		
	1988	1989	1990	1991	1992	1993
Nominal GNP (Billions of dollars)						
Administration	4,860	5,219	5,577	5,947	6,304	6,648
CBO	4,859	5,209	5,542	5,902	6,281	6,685
Real GNP (Percent change, year over year)						
Administration	3.8	3.3	3.2	3.3	3.2	3.2
CBO	3.8	2.9	2.1	2.2	2.2	2.3
Consumer Price Index ^a (Percent change, year over year)						
Administration	4.0	3.8	3.7	3.2	2.7	2.2
CBO	4.0	4.9	4.9	4.6	4.4	4.4
GNP Deflator (Percent change, year over year)						
Administration	3.4	4.0	3.6	3.2	2.7	2.2
CBO	3.4	4.2	4.2	4.2	4.1	4.1
Three-Month Treasury Bill Rate (Percent)						
Administration	6.7	7.4	5.5	4.5	4.0	3.5
CBO	6.7	7.9	7.1	6.7	6.4	6.1
Ten-Year Government Bond Rate (Percent)						
Administration	8.9	8.6	7.2	6.0	5.0	4.5
CBO	8.9	9.3	9.0	8.6	8.1	7.7
Civilian Unemployment Rate						
Administration ^b	5.4	5.2	5.1	5.0	5.0	5.0
CBO	5.5	5.5	5.5	5.5	5.6	5.6
Tax Bases						
Wage and salary disbursements						
Administration	2,436	2,609	2,783	2,973	3,163	3,347
CBO	2,435	2,615	2,787	2,969	3,163	3,370
Other personal income ^c						
Administration	1,625	1,724	1,856	1,958	2,045	2,121
CBO	1,626	1,754	1,870	1,977	2,090	2,211
Corporate Profits ^d						
Administration	302	352	399	442	475	499
CBO	299	328	351	378	390	401

SOURCES: Congressional Budget Office; Office of Management and Budget.

- Consumer Price Index for urban wage and clerical workers.
- The Administration's projection is for the total labor force, including armed forces residing in the United States, while the CBO projection is for the civilian labor force excluding armed forces. In recent years, the unemployment rate for the former has tended to be 0.1 to 0.2 percentage points below the rate for the civilian labor force alone.
- Other personal income is personal income less wage and salary disbursements.
- Corporate profits reported are book, not economic, profits.

CBO BUDGET ESTIMATES

CBO's estimates of the deficit, assuming that REFCORP is treated as an on-budget entity, exceed the Administration's figures by \$40 billion in 1990 and increasing amounts in later years. In 1990, \$22 billion of the \$40 billion in reestimates is attributable to REFCORP. In 1991 through 1993, most of the reestimates are economic.

Effects of Economic Assumptions

The differences between CBO's economic assumptions and those of the Administration lead to substantially different budget estimates, primarily on the outlay side. The combination of lower real growth and higher inflation in CBO's assumptions produces nominal incomes and tax receipts close to the Administration's. Despite lower nominal GNP projections, CBO projects slightly higher tax receipts in 1988 and 1989 than does the Administration; projected receipts are higher because CBO assumes more income in the form of wages and salaries and capital gains. CBO projects, however, somewhat lower tax receipts than the Administration in 1991 through 1993, largely because of a smaller corporate income-tax base.

CBO's economic assumptions increase outlays by \$13 billion in 1990 and \$72 billion in 1993, as shown in Table 4. CBO's projection of higher inflation leads to higher outlays for federal retirement programs, Medicare and Medicaid, and other benefit programs. CBO's higher interest rates increase the cost of federal borrowing. Finally, economic reestimates of revenues and outlays increase debt service costs. In total, CBO's economic assumptions increase the estimated deficit by \$9 billion in 1990, growing to \$78 billion in 1993.

TABLE 4. EFFECTS OF CBO ECONOMIC ASSUMPTIONS ON ESTIMATES OF THE ADMINISTRATION'S BUDGET
(By fiscal year, in billions of dollars)

	1989	1990	1991	1992	1993
Revenues	5	4	-1	-3	-7
Outlays					
Benefit programs	a	4	9	15	24
Net interest					
As a result of interest rates	1	9	21	31	38
Debt service	<u>a</u>	<u>a</u>	<u>2</u>	<u>5</u>	<u>10</u>
Total Outlays	1	13	32	51	72
Deficit	-4	9	33	55	78

SOURCE: Congressional Budget Office.

NOTE: The totals include Social Security, which is off-budget.

a. Less than \$0.5 billion.

Effects of Technical Estimating Assumptions

CBO's technical reestimates of the Bush budget increase the estimated 1990 deficit by \$8 billion, the result of \$11 billion in higher outlays offset by \$3 billion in higher revenues (see Table 5). CBO

TABLE 5. EFFECTS OF CBO TECHNICAL ASSUMPTIONS ON ESTIMATES OF THE ADMINISTRATION'S BUDGET
(By fiscal year, in billions of dollars)

	1989	1990	1991	1992	1993
Revenues					
Current law	-1	5	3	2	7
Capital gains tax reduction	0	-2	-9	-10	-9
Other proposals	<u>a</u>	<u>a</u>	<u>-1</u>	<u>-1</u>	<u>-1</u>
Total Revenues	-1	3	-7	-9	-2
Outlays					
National defense	-2	4	4	4	4
Leasing of Arctic National Wildlife Refuge	0	2	-2	0	a
Farm price supports	-1	-1	-1	-1	-1
FDIC	a	3	3	4	4
Medicaid and Medicare	a	1	1	-1	2
Income security	a	2	-3	3	4
Social Security	a	a	-1	-2	-3
Net interest	-1	-1	2	4	6
Federal Communications Commission auction receipts	0	2	1	0	0
Proposed asset sales	0	a	a	2	2
Other outlays	<u>-1</u>	<u>-1</u>	<u>a</u>	<u>1</u>	<u>2</u>
Total Outlays	-3	11	10	13	19
Deficit	-2	8	17	22	22

SOURCE: Congressional Budget Office.

NOTE: The totals include Social Security, which is off-budget.

a. Less than \$0.5 billion.

expects that the 1990 proceeds from the Administration's proposals to sell oil and gas leases in the Arctic National Wildlife Refuge and to accept competitive bids for use of the unassigned radio spectrum will be \$4 billion less than the Administration assumes. CBO's estimates of spending for defense and for the Federal Deposit Insurance Corporation are also higher by \$4 billion and \$3 billion, respectively.

After 1990, technical estimating differences between CBO and the Administration average \$20 billion per year. Almost half of this disparity stems from differing estimates of the Administration's capital gains proposal. The Administration contends that reducing the tax rate on capital gains will permanently increase realizations of gains by enough to offset the revenue loss from the lower rate. CBO and the Joint Committee on Taxation (JCT) judge that, after an initial surge in 1990, the increase in realizations will not be sufficient to offset the rate reduction. While the Administration estimates that its capital gains proposal would raise revenues by \$5 billion in 1991, CBO and JCT estimate a revenue loss of \$4 billion. Similar estimating differences prevail in 1992 and 1993.

The Savings and Loan Problem

CBO discussed the budgetary implications of the Administration's plan to resolve the savings and loan crisis in testimony before the Senate Banking Committee last week. That testimony is attached as an appendix to my statement. In brief, the Administration proposes to spend \$205 billion over the 1989-1999 period. Of this amount, \$136 billion would be for resolving insolvent thrift institutions, administering the program, and paying off Federal Savings and Loan Insurance Corporation (FSLIC) notes. The remaining \$69 billion would be paid to service the debt incurred in financing the plan.

The bulk of the needed cash would be raised through borrowing. A new entity, the Resolution Financing Corporation, would borrow \$50 billion in private credit markets in 1989 through 1991 to help finance near-term resolutions. The existing Financing Corporation would raise \$7 billion, and the Treasury would borrow \$84 billion. Liquidation proceeds, the Federal Home Loan Banks, savings and loan assessments, and other FSLIC income would provide the remaining \$64 billion.

The Administration proposes that REFCORP be treated as an off-budget entity. In CBO's view, however, REFCORP would not truly be privately owned and should be included in the budget. Moreover,

we believe that the Treasury should do all borrowing, which would be less costly and quicker than borrowing through a new funding agency.

Spending the \$50 billion in borrowed funds, however, would have virtually no macroeconomic impact. Thus, one can make a good case for excluding such spending from Balanced Budget Act calculations in the same manner as asset sales and loan prepayments are now excluded. Excluding spending from Balanced Budget Act calculations may set unfortunate precedents, but so does creating off-budget entities to perform governmental functions. Ultimately, the appropriate budgetary treatment for financing a solution to the savings and loan problem is a policy matter that should be settled by the Congress and the President.

THE ADMINISTRATION'S BUDGET PROGRAM

The Bush Administration's budget program divides the spending side of the budget into two categories. For most of the budget--just over \$1 trillion in 1990--the Administration makes specific spending proposals. Another \$136 billion in spending, however, is subject to what the Administration refers to as a flexible freeze. The Administration proposes that total outlays for this residual category

be held to their 1989 level and that decisions about spending for specific residual programs be determined through negotiations involving the Congress and the Administration. In the meantime, however, the Office of Management and Budget has told the agencies that "the Reagan budget proposals within the residual category are to be treated as if they were the Bush Administration proposals for purposes of starting the budget process with the Congress."

CBO's analysis of the Bush proposals follows the same format. For programs where the Administration has made specific proposals, we have priced them out. For the residual programs, we have taken the Bush Administration's figure of \$136 billion as a target. The Reagan Administration's proposals for these same programs, however, would have resulted in spending of \$138 billion in 1990. Thus, just over \$2 billion in unspecified spending reductions beyond those contained in the Reagan budget would be required to reach President Bush's target.

Comparison with the Baseline

CBO's baseline budget projections provide a benchmark against which one can measure the Administration's budget program. The baseline projects the course of the budget on the assumption that current tax-

ing and spending policies continue unchanged. It generally assumes that tax and entitlement laws now on the statute books will continue. National defense and nondefense discretionary appropriations are assumed to keep pace with inflation. Because the baseline and the CBO estimate of the budget employ the same economic and technical estimating assumptions, differences between the two are solely the result of proposed policy changes.

CBO estimates that the Bush Administration's budget proposals would reduce the deficit by \$15 billion in 1990 and \$38 billion in 1993, as shown in Table 6. Over \$9 billion of the \$15 billion reduction in 1990 would come out of the residual programs, for which President Bush has made no specific proposals. The residual category consists almost entirely of programs within the spending jurisdiction of the Appropriations Committee, although some of these are mandatory programs, such as payments to the states for foster care and the administrative expenses of food stamps and family support. In addition, the residual category contains a number of offsetting receipts and permanent appropriations, notably the Postal Service fund. The \$2 billion in unspecified savings needed to hold residual programs to \$136 billion in outlays arises primarily because the outlays of the Postal Service will grow by about \$2 billion from 1989 to 1990.

President Bush's defense request is intended to provide a constant level of real budget authority for the military activities of the Department of Defense in 1990. It would provide real increases of 1 percent in 1991 and 1992 and 2 percent in 1993, using the Administration's economic assumptions. It would provide little if any real growth, however, under CBO's higher inflation assumptions. The

TABLE 6. THE BUSH ADMINISTRATION'S BUDGET PROGRAM
AS ESTIMATED BY CBO (By fiscal year, in billions of dollars)

	1990	1991	1992	1993
CBO Baseline Deficit	146	146	140	135
Proposed changes				
Revenues ^a	-4	b	2	3
National defense	1	-2	-5	-6
Nondefense discretionary spending	1	2	3	3
Entitlements and other				
mandatory spending	1	-6	-16	-17
Offsetting receipts	-1	-5	-3	-5
Asset sales and prepayments	-3	-2	-1	1
Net interest	-1	-3	-5	-7
Residual programs	<u>-9</u>	<u>-8</u>	<u>-10</u>	<u>-10</u>
Total Proposed Changes	-15	-22	-35	-38
Deficit, Bush Administration Budget as Estimated by CBO ^c	131	124	104	97

SOURCE: Congressional Budget Office.

NOTE: The totals include Social Security, which is off-budget.

- a. Revenue increases are shown with a negative sign because they reduce the deficit.
- b. Less than \$0.5 billion.
- c. Including asset sales and REFCORP.

Administration also proposes more spending to clean up and modernize nuclear weapons facilities. While details of the defense program are not yet available, CBO estimates that it would increase outlays slightly in 1990 compared with the baseline and reduce them in later years.

The Bush Administration makes specific proposals for about 40 percent of nondefense discretionary spending. Increases over baseline levels are requested in 1990 for international affairs, science and space, the decennial census, Federal Aviation Administration and Coast Guard operations, certain education initiatives, health research, and drug control and enforcement. The Administration proposes to reduce spending by eliminating direct loans by the Farmers Home Administration and Rural Electrification Administration and replacing them in part by guaranteed loans and vouchers. On balance, outlays for enumerated discretionary programs would be \$1 billion higher than the CBO baseline in 1990.

The Bush Administration's proposals for entitlements and other mandatory spending differ from the Reagan budget in three major respects. First, the Administration would substantially increase spending to resolve the savings and loan crisis, as previously described. Second, President Bush proposes no specific reductions in Medicaid or other means-tested benefits. Third, he recommends a new

refundable tax credit for each child under age four in low-income working families. Bush adopts the Reagan proposals for reductions in Medicare, federal retirement benefits, and farm price supports. He also retains almost all of Reagan's proposed increases in offsetting receipts and most of his proposed asset sales.

Compared with the CBO baseline, the Bush Administration's revenue proposals would reduce the deficit by \$4 billion in 1990 but would increase it slightly thereafter. This pattern follows that of the proposed reduction in the capital gains tax rate, which CBO estimates would increase revenues by \$3.3 billion in 1990 and reduce tax collections in 1991 through 1993. In addition to the capital gains proposal, the Bush Administration has proposed the establishment of enterprise zones, extension of the excise tax on telephone use, a child care credit, and additional incentives for oil and gas exploration. Otherwise, President Bush has endorsed the tax proposals contained in the Reagan budget, including extension of Medicare taxes and coverage to all employees of state and local governments, maintenance of airport and airway taxes at 1989 rates, increased Internal Revenue Service funding to enforce tax laws, and inducements for research and experimentation.

Implications for the Appropriations Committee

What are the implications of the Bush budget proposals for the programs in the jurisdiction of the Appropriations Committee? Table 7 compares the allocation of budget authority and outlays to the Appropriations Committee under four different alternatives in the categories used for the 1987 budget summit. First is the CBO baseline, which increases discretionary budgetary resources--budget authority, obligation limitations, and credit limitations--by the rate of inflation. Second is a resource freeze, which holds discretionary budget authority and other budgetary resources constant at their 1989 levels. The third and fourth alternatives are the Reagan and Bush budgets, as estimated by CBO.

The Bush budget would cut budget authority for mandatory appropriations compared with current law, but by less than the Reagan budget. These mandatory programs are effectively controlled by other committees, however, and the Appropriations Committee is held harmless for their actions or inactions.

The story for discretionary appropriations is complicated by the presence of \$2.2 billion in unspecified outlay savings in the Bush budget. Table 7 shows what would happen if none of these unspecified savings came from discretionary appropriations. In that case, defense

discretionary budget authority would total \$310.0 billion--the same as the CBO baseline and \$5.9 billion less than the Reagan request.

TABLE 7. PROGRAMS IN THE SPENDING JURISDICTION OF THE APPROPRIATIONS COMMITTEE, FISCAL YEAR 1990
(In billions of dollars)

	Mandatory	Defense Discre- tionary	Nondefense Discre- tionary	Total
Budget Authority				
CBO Baseline	158.7	310.0	181.8	650.4
Resource Freeze	158.7	299.6	173.1	631.3
Reagan Budget, as Estimated by CBO	152.0	315.9	173.9	641.9
Bush Budget, as Estimated by CBO ^a	155.5	310.0	175.0	640.5
Outlays				
CBO Baseline	157.7	304.1	199.3	661.7
Resource Freeze	157.7	298.5	194.1	650.3
Reagan Budget, as Estimated by CBO	150.8	307.2	195.1	653.1
Bush Budget, as Estimated by CBO ^a	154.2	304.8	196.1	655.1

SOURCE: Congressional Budget Office.

a. These figures do not include \$2.2 billion in unspecified outlay savings and the corresponding reductions in budget authority.

Nondefense budget authority would amount to \$175.0 billion--\$6.8 billion below the baseline but \$1.1 billion more than the Reagan budget. If any of the unspecified reductions were taken out of discretionary appropriations, the budget authority figures would be correspondingly lower. If the cuts were spread in a typical fashion, about \$165 million in budget authority reductions would be required to reduce 1990 outlays by \$100 million. If half the unspecified cuts were taken from nondefense discretionary appropriations, the total required reductions would be similar to those resulting from a freeze on budgetary resources.

As this Committee knows, President Bush's budget proposals have not been presented in the usual detail, and further information about them emerges each day. We will inform the Committee staff promptly if any of this new information causes a significant change in our conclusions. We look forward to assisting the Committee in your work on the 1990 budget.

CBO BUDGET ESTIMATES

The CHAIRMAN. Thank you, Dr. Reischauer, and thank you for the offer to provide additional information as it becomes available to this committee.

President Bush has not yet provided any account level detailed limits to the Reagan budget. Apparently, he intends to do so for his priorities, but he has lumped all other accounts into a \$136 billion category called nondefense, mostly discretionary spending.

Mr. Darman testified before this committee that for purposes of beginning the budget process, we should accept the Reagan figures for every account in the category. Has this approach to the military aid budget caused any difficulties for CBO in carrying out your responsibility?

Dr. REISCHAUER. It has made the task more difficult this year than it has been in other years. Without the detail, it is very hard to provide this committee with detailed figures on the amount of budget authority that would be necessary to cut from our baseline to achieve the outlay estimates that are anticipated by the Bush proposal. We continue, however, to have a good staff-to-staff relationship with OMB and share information as it becomes available on a steady basis.

The CHAIRMAN. In your table on page 18, you set forth the CBO estimate of the baseline deficit. For fiscal year 1990, the resulting deficit, according to CBO, would be \$131 billion. Is that the figure that would be used in the Gramm-Rudman-Hollings calculations?

Dr. REISCHAUER. No. The Gramm-Rudman-Hollings Act excludes asset sales, and those would have to be taken out. Then there is the question of how REFCORP, the Resolution Financing Corporation, should be handled. CBO believes that the \$22 billion that is attributable to REFCORP should not be included in the Gramm-Rudman calculation because we anticipate that this spending will have virtually no effect on the macroeconomy.

Excluding both the asset sales and REFCORP financing, the deficit anticipated by CBO for the Bush proposal is \$109 billion.

The CHAIRMAN. So using your figure of \$109 billion, if your estimates are correct and if President Bush's proposals are enacted, we should fall short by \$9 billion in outlays; is that correct?

Dr. REISCHAUER. That is right, we would be \$9 billion over the \$100 billion target in the Deficit Reduction Act.

ADMINISTRATION PROPOSALS

The CHAIRMAN. Under the heading "Proposed Changes" on table 6, there is listed a \$4 billion reduction in the deficit from increased revenues. That would be made up by the capital gains tax figure, if enacted, and the other increased revenues, amounting to about \$700 million, plus the \$3.3 billion under capital gains; is that correct?

Dr. REISCHAUER. Yes, the \$4 billion is actually a sum of about \$3.3 billion in capital gains revenues and an extension of the Medicare or hospital insurance tax to all State and local employees, which would raise another \$1.7 billion, the elimination of the scheduled reduction in the airport and airways taxes, and some in-

creased enforcement of tax collections by the Internal Revenue Service.

But on the other side, there are some decreases in revenues, and those would come from the proposal to establish enterprise zones, which would be a small amount; provisions that would increase the benefits for research and experimentation; certain additional tax breaks for oil and gas exploration; and finally, the new child care tax proposal that the administration has suggested.

The CHAIRMAN. What is your estimate of the budget authority cuts that would have to be made by the Appropriations Committee to achieve the \$9 billion in outlay savings?

Dr. REISCHAUER. That is a difficult calculation, because CBO does not have the details for the \$9 billion worth of outlay reductions that the administration anticipates from these unspecified domestic discretionary programs.

If we assumed that the cuts will be proportionate across all of the programs in that category, we would get a figure of about \$15 billion of reductions in budget authority to achieve the \$9 billion reduction in outlays.

Senator DOMENICI. Mr. Chairman?

The CHAIRMAN. Yes.

Senator DOMENICI. I wonder if you might permit me to ask a clarifying question on the \$9 billion?

The CHAIRMAN. Yes.

Senator DOMENICI. I might also say, Mr. Chairman, I am supposed to be at another hearing on the budget, and I would just like a moment, and I will try to clarify another approach to that \$9 billion.

The CHAIRMAN. Surely.

Senator DOMENICI. I think that may be of interest to the Chair.

The CHAIRMAN. The Chair would be happy to accommodate the Senator from New Mexico.

Senator DOMENICI. Since this is the first appearance of the new CBO Director, and I have worked closely with all of his predecessors, might I say, that while I regret the delay in his appointment, I feel very comfortable that the delay has yielded a CBO Director that is going to do the Congressional Budget Office justice. We are proud of you for taking this job; I compliment you for your service.

It is obvious, and it should be to everyone here, that you are very well equipped for this job. You have only been on the job for a few days, and while it might not show to many, you are answering some very, very difficult questions about a complicated budget process. I think that bodes well.

DEFICIT TARGET AND EFFECT OF ECONOMIC ASSUMPTIONS

Having said that, could I just clarify the \$9 billion by which we exceed the \$100 billion deficit target under the Gramm-Rudman-Hollings Act. That is the Federal deficit would be \$109 billion if all of President Bush's proposals were adopted. Am I not correct that by coincidence, the \$9 billion is reflected in an interest adjustment due to an economic assumption on interest rates? Is not that \$9 billion the difference between CBO's estimate of interest rates and President Bush's estimates? That turns out right, doesn't it?

Dr. REISCHAUER. It is the total effect of the economic differences which have some pluses and minuses.

Senator DOMENICI. Fine; that is even better.

Dr. REISCHAUER. But it is the economic differences. Let me thank you for your welcoming remarks and also say that while I have been on the job now 3 days, I still feel like I have been placed in the front car of a roller coaster halfway down the steep hill, and I am still trying to find where to put my bottom. [Laughter.]

Senator DOMENICI. You will get leveled out very well. You won't go off the hill. But I think the point I want to make is that while it may be accidental in this case, Mr. Chairman, let me suggest that we would not need to find \$9 billion in additional outlay cuts to comply with the Gramm-Rudman Act deficit target if we implement the President's budget and assume that OMB turns out right on economic assumptions.

Let me give you my reasoning and see if the Director would agree with it. Let's assume that the U.S. Senate adopts the President's economic policies instead of CBO's. We would cut \$9 billion off the deficit, all of which is attributable to economic assumptions, and we would be at \$100 billion.

Now, we would then go all the way to sequester time and the passage of the appropriations bills, and if everything was done as per the expenditure side and the revenue side as recommended by the President, we would be at a \$100 billion deficit. We would then do the economic adjustments, and we would be at a \$109 billion deficit. That is precisely what the drafters of the Gramm-Rudman-Hollings Act envisioned when they put in a \$10 billion window.

The deficit target is not \$100 billion; the deficit target is \$110 billion. If you exceed it, you get sequestered, but if you come within the \$110 billion range, you are all right.

It happens, in this case, that that entire \$9 billion is the kind of thing that the margin of error was intended to cover, because you cannot be sure you are right on the economic assumptions. The President is not sure he is right; none of us are sure that either of you are right; and we shouldn't be. We are making the best estimates up front.

But if all that occurred, we would be at a point in time where the deficit would be \$100 billion under the Bush economics, and then we would have \$10 billion in latitude that could be used up by economic adjustments, as the Gramm-Rudman Act intended.

Now, where we would go astray is if we spent more money or reduced taxes. Then, of course, that would not be an economic assumption; that would be breaking the \$100 billion target by a covert act. Last year we did that; we spent \$10 billion extra, and then we had a \$9 billion economic adjustment, so it turned out to be \$19 off the deficit target.

But am I not correct that since this \$9 billion is due to economic assumptions, if we assume the President is right, we will be within the deficit targets, and no sequester will occur.

Dr. REISCHAUER. Everything you have said is correct, but I would just add that when the sequestration decision is being made and contemplated, we will be operating under a different set of economic assumptions, ones that OMB will be releasing some time in the middle of the summer.

Senator DOMENICI. July.

Dr. REISCHAUER. July 15; right.

Senator DOMENICI. That is the followup economic report, but assume that they still have——

Dr. REISCHAUER. If nothing changes with their forecast and with ours, you are right.

Senator DOMENICI. Thank you, Mr. Chairman.

The CHAIRMAN. But is it also accurate to say that Gramm-Rudman-Hollings requires us to shoot at the target of \$100 billion, not \$109 billion, not \$110 billion, which allows for the cushion, but \$100 billion? Isn't that accurate?

Dr. REISCHAUER. Yes, that is accurate, and I think that is what Senator Domenici was saying.

Senator DOMENICI. Yes.

Mr. Chairman, the deficit target would be \$100 billion. You would reach it, and the only activity that would occur to break it are differing economic assumptions. It is an accident today in this testimony that the \$9 billion by which CBO estimates that the Bush budget exceeds the \$100 billion deficit target happens to be all based on economic assumptions at this point. We would get to a \$100 billion deficit if we used the President's economic assumptions and enacted his program, assuming the \$22 billion for the S&L bailout is not on budget, which you describe very well.

Thank you very much, Mr. Chairman.

The CHAIRMAN. But you also have to assume or you are assuming also that his proposals are going to be enacted.

Senator DOMENICI. I assumed that was the basis of our question. I think you asked: How much more would we have to cut to achieve the \$100 billion, how much more than President Bush recommended, yes.

Thank you very much.

ENTITLEMENT PROPOSALS

The CHAIRMAN. Thank you, Senator Domenici.

Under the entitlements and other mandatory spending, what are the administration's proposals?

Dr. REISCHAUER. In the entitlement area, the administration has proposed a number of reductions similar to those included in the Reagan budget proposal with one major exception; it does not contain the suggestion that the Reagan administration budget did to make severe cuts in the Medicaid Program. It does, however, suggest that \$5 billion of savings be taken from the Medicare Program; that the Farm Price Support Program be reduced by roughly \$2 billion; and that the cost-of-living adjustments for Federal, civilian, and military retirees be eliminated as well as certain lump-sum options for members of civil service retirement plans when they retire, and that health benefits for annuitants be reduced, creating a further savings of roughly \$4 billion.

In addition, there is a \$1 billion reduction caused by continuing the 1-percent origination fee that is charged to veterans on their guaranteed housing loans.

IMPLICATIONS FOR THE APPROPRIATIONS COMMITTEE

The CHAIRMAN. So if none of the administration's proposals were to be enacted, none of them, what would be CBO's estimate of the resulting outlay cuts that this committee would likely be stuck with for fiscal year 1990?

Dr. REISCHAUER. The outlay costs would sum to about \$34 billion.

The CHAIRMAN. What is your best guess of the cuts in budget authority that would have to be made in fiscal year 1990 to achieve \$34 billion in outlay savings?

Dr. REISCHAUER. With the same set of assumptions that I mentioned for the \$9 billion worth of outlay savings, where specific proposals are absent, CBO would estimate that about \$58 billion of budget authority would have to be eliminated.

The CHAIRMAN. All right. If we fund defense at the level requested by the President, \$310 billion in budget authority, if we fund international affairs at the President's request of \$19.4 billion, then the cut of \$58 billion in budget authority would have to come from domestic discretionary programs. What is the total budget authority for these programs in CBO's baseline?

Dr. REISCHAUER. The baseline suggests that the budget authority for that set of programs is \$161 billion.

The CHAIRMAN. So this leaves this committee in the position of having to cut appropriations for domestic discretionary programs by 36 percent in fiscal year 1990 assuming, as we have in this line of questions, that none of the President's proposals were to be enacted. We would not only have to eliminate the President's priorities in education, research and development, drug treatment, prevention, homelessness, and so forth.

We would also have to cut 36 percent from the baseline from virtually every domestic discretionary program in the budget.

I have further questions. I am going to turn now to Senator Stevens for any questions he may wish to ask.

Senator STEVENS. Well, I thank you, Mr. Chairman, and I welcome—is it Dr. Reischauer?

Dr. REISCHAUER. Reischauer.

Senator STEVENS. Reischauer. Someone said "Doctor." I didn't know whether I should be addressing you as Doctor.

EFFECT OF OIL PRICES ON THE DEFICIT

Senator STEVENS. Could you tell me what assumptions you have in your analysis for the price of oil in the future?

Dr. REISCHAUER. It is about \$17 per barrel at the end of calendar year 1989, and it grows 2 percent per year in real terms in the future. The real price of oil will, therefore, be rising gradually.

Senator STEVENS. I thought that was the case, it was close to that. The price of oil today, at least west Texas crude, is \$18.55. The high last year was \$19.30. Those of us in the oil patch think that the price of oil is going up.

One of the reasons is that my State now currently supplies one-half of the domestic production, 25 percent of our total consumption. By January of this year, we imported 51 percent of our oil. I don't know if you are aware of it, but unless we do bring on additional production of a great magnitude from Alaska, the through-

put of our pipeline will decrease to 600,000 barrels a day from 2.1 million now to 600,000 by 1998.

The reason I mention this is that currently, 25 percent of our balance of trade deficit is reflected in our imported oil. If we have to increase imports to make up for the declining production in Alaska, we will reach the point, according to my calculations, where we would be in the vicinity of 75 percent of our oil consumption coming from overseas.

The consequence of that, in terms of outflow of dollars, is not only reflected in cost of oil but also in the cost of getting the dollars back. I would encourage you to take a better look at the price of oil and what it is going to do to this budget in the future. I think the thing that is going to exacerbate the budget process and eventually bring about a triggering of the Gramm-Rudman-Hollings sequester is the price of oil.

We are an energy intensive government, are we not?

Dr. REISCHAUER. We are; we are an energy-intensive economy.

Senator STEVENS. Yes, but particularly the Government. You look at the Department of Defense, the Postal Service, which is still on budget—it shouldn't be, but it is—and other items, even the increasing use of technology and computers and everything else; we are energy intensive.

I would urge that the Congressional Budget Office start looking at that to see how serious a problem it is going to be when the price of oil starts going up again.

We had oil approaching \$30 a barrel. It approached \$20 a barrel last year; \$19.30 was the high last year. In my judgment, if we do not open up new resources in Alaska—and Congress will make that decision—I don't know how persuasive we will be, but if we do not, and furthermore, if we are not successful even there, if we get to those lands, we face, in my judgment, within the spectrum of the analysis you have given us, a \$30 a barrel price of oil.

I think the consequences of that are double digit inflation and double digit interest rates again for a long period, plus really an exacerbated budget to the extent of probably about \$30 to \$40 billion difference, according to the estimate of my staff and I.

I would like to see you give to us a projection of what will happen at a \$25 price of oil; what will happen at a \$30 price of oil in this timeframe that you presented your estimates. The administration, as I understand it, has assumed the price of oil is even less than yours. I don't know if you know that; isn't that correct?

Dr. REISCHAUER. Yes, sir.

Senator STEVENS. One thing I hope, and I don't really have any other questions, but I hope that you will work with Dick Darman to try to eliminate these differences in analyses. I think one of the real problems we have is we are relying on different economic assumptions, and we end up with different numbers. It becomes a numbers game.

We had that once before when the House had a computer that was filled by one set of statistics and we had one filled with another. We eliminated that with you. We don't have computer fights anymore, but it looks like we have got economic analysis fights coming during this year, which I would hope that we would be able to avoid. Darman is new, and you are new, and I would urge you to

sit down and see how close we can come to using the same economic assumptions so that we won't have an economic assumptions battle at the time of the sequester period.

Otherwise, I welcome you, and I think it would be, and I don't know whether the other people, anyone else would join me, but I think it would be an interesting thing for us to see what is going to happen as far as this budget process is concerned if the price of oil goes up precipitously in the period of time we are talking about.

Dr. REISCHAUER. Senator, CBO will be glad to provide you with a brief analysis.

[The information follows:]

The Congressional Budget Office's economic forecast assumes that the average cost of petroleum to domestic refiners will be about \$16.70 per barrel in 1991. Assumptions about the price of oil are particularly uncertain, but CBO does not yet see a strong reason to change this assumption.

Oil price increases alone are clearly harmful to the economy and to the budget. In the past, however, large increases in oil prices have occurred when the world economy was exceptionally strong, unlike the situation in our forecast. Thus, a higher forecast for oil prices would probably assume strength in other parts of the economy. This could offset, fully or in part, the effects of higher oil prices on real output levels and the budget. In the discussion that follows, we do not consider the effects of other economic changes that could bring about sharply higher oil prices.

If world oil prices were to rise very sharply, CBO would expect to see a corresponding sharp, but temporary, increase in inflation. We have considered two scenarios: in one, the oil price rises to \$25 per barrel on average in 1991, and in the other, it rises to \$30. With the smaller increase in oil prices, consumer prices would probably rise by a total of an additional 1.5 percent, raising the inflation rate in 1990 and 1991 by about 0.7 percentage point. The larger increase in oil prices would have more severe effects; consumer prices would be about 2.5 percent in 1991, and the inflation rate would be about 1.3 percentage points higher in 1990 and 1991. Changes in the GNP deflator would reflect about three-quarters of the changes in consumer prices.

Further changes in inflation and interest rates would depend on the response of the Federal Reserve to higher oil prices. Recent Federal Reserve policy statements emphasized the goal of keeping inflation down. Thus, we assume that the money supply would be kept tight enough to prevent any significant lasting increase in inflation, beyond the short-run increases described in the preceding paragraph. This would imply that short-term interest rates would increase at least as much as inflation: at least 70 basis points if oil prices rise to \$25 and 130 basis points if oil prices reach \$30 by 1991.

Higher oil prices would clearly benefit U.S. energy producers, but would impose costs on users of energy. Together with higher interest rates, this would work to reduce real output levels. How much lower real output would be with higher oil prices also depends in large part on how the Federal Reserve responds. If the Federal Reserve is able to keep growth in the money supply at about the same rate, and interest rates increase about as much as inflation, as suggested above, then real GNP would fall by about as much as the GNP deflator rises. In the case of oil prices of \$25 per barrel, real GNP in 1991 would be about 1 percent lower than in the economic forecast underlying the CBO baseline. In the case of oil prices of \$30, real GNP might be reduced below baseline values by about 1.8 percent.

A broad examination of the response of economic models to oil price changes (conducted by the Energy Modelling Forum at Stanford) suggests slightly larger reductions in real GNP: about 1.4 percent in 1991 if the price rises to \$25 per barrel, and 2.2 percent if the price rises to \$30. These numbers should, however, be regarded with caution, since they are based on model results that refer to a different period—the early 1980s—when oil prices were much higher, and when there was much more unused capacity in the economy than there is now. Moreover, they are averages from widely different results from different models. CBO views these choice results as similar, within reasonable bounds of error, to its own.

Higher oil prices would affect the Federal budget both directly and indirectly. Some parts of the Federal budget are directly affected by energy prices and use. Among these are certain excise tax collections, purchases of oil for defense use and for the Strategic Petroleum Reserve, and receipts from Outer Continental Shelf oil leases. But these direct effects are generally outweighed by the indirect effects on

the budget stemming from the impact of oil prices on the economy. According to the analysis just discussed, higher oil prices would tend to raise inflation and interest rates and reduce real growth. The effects on Federal revenues are mixed, but outlays for benefit programs, net interest, and other purposes would go up. We estimate that the deficit in fiscal year 1991 would increase by approximately \$10 billion in the case of \$25-per-barrel oil, and by about \$15 billion to \$20 billion in the \$30-per-barrel alternative. These calculations examine the results of oil prices that exceed CBO's forecast, but do not consider why they might be higher. If high oil prices came about as a result of strong economic growth in the United States and elsewhere, these budget effects would be offset or reversed.

Dr. REISCHAUER. CBO's projected price does rise close to the \$25 price, probably by the end of the projection period in 1994. I think you are suggesting that we could have a—

Senator STEVENS. I think we could have more than that, by 1991.

Dr. REISCHAUER [continuing]. A precipitous rise.

Senator STEVENS. Our projection is that it will be that by 1991 if we don't have an assured supply of oil to come on line to replace the decreasing production, not only Alaska; we have lost 1½ million barrels a day in the Chipawah country that Senator Nickles hails from.

I think it is a real problem for us in the future to think, and when I was first here in the Senate, we had the term petrodollars, and we are all trying to figure out how to get the petrodollars back. We are going to have a problem next time. That was only about 40 percent of our consumption in imports. We are already over that; we are at 51 percent now.

Again, I wish you well and look forward to working with you.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Stevens.

Senator Bumpers?

Senator BUMPERS. Mr. Chairman, would you allow me to defer for just a few minutes and go on to Senator Grassley?

The CHAIRMAN. Absolutely; yes, indeed.

Senator Grassley?

PRECISION OF ECONOMIC FORECASTS

Senator GRASSLEY. I don't have a question, and what I was going to mention as way of just discussion and point of view, particularly because you are new in the position and a reflection on my 8 years on the committee as a natural follow-up where Senator Stevens just left off and that is a feeling on my part about the need to use sound analysis on your economic assumptions.

I know in the last few years, at least the last 2 years, the Congressional Budget Office has done a very good job at that, I guess consistently better than OMB, as I recall on their projections of what the deficit is going to be, and the deficit has always turned out worse than we had analyzed it, because we always had these rosy projections. Nobody wants to admit down the road you could have an economic turndown.

That is something that evidently every public official and public agency abhors, and yet we all know it is going to happen. But even the Congressional Budget Office, early on in this decade, was very rosy in their projections of what the economic assumptions were going to be and how small the deficit was going to be, and then a few years ago, some of us on this committee started pointing out

the fact that we ought to be a little more precise in our approach to it.

I think that, obviously, change has been brought about and that CBO is much more precise and careful. My only admonition is I don't think you can ever refine that to too great of an extent to be as precise as you can and be as honest as you can. I am glad that we have a better record through your agency than OMB does.

I hope that from that standpoint and what Senator Stevens was saying, when we reach economic assumptions, my feeling would be, well, you can't do anything but be honest, and for political reasons, we can't be compromising with any other person that does not want to see what or make sure what the true picture is.

So No. 1, even though there is improvement, I guess I would say to you, still be looking for better improvement on this so that we can establish a record that can't be challenged in any way; and then third, even though I want to see a summit between the executive branch and the Congress, I don't want to see that summit come because any principles on economic projection are forecast just to reach an agreement at the bargaining table.

Mr. Chairman, that is all I have. If you want to comment, you can. If you want to react, you can react. Go ahead.

Dr. REISCHAUER. I thank you for your praise of CBO's history in economic forecasting and budget forecasting. Under my tenure, I can assure you that CBO will be as straight and objective as it can. It will provide you with its best estimates and there will be no bias.

Senator GRASSLEY. Mr. Chairman, I am done.

The CHAIRMAN. Thank you, Senator Grassley.

Senator BUMPERS, are you ready to proceed?

Senator BUMPERS. Yes.

DIFFERENCE BETWEEN CBO'S AND OMB'S PROJECTION FOR THE DEFENSE BUDGET

Has anybody asked you about the difference between the defense budget and OMB's projection and yours? I have read that CBO thinks there is perhaps a difference of \$2 billion, that there is \$2 billion in real growth in the Bush budget, and if that is correct, how did it happen?

Dr. REISCHAUER. This is a very complex issue. CBO's estimates of the outlays that will result from the Bush budget proposals are \$1 billion above its projections for the baseline Department of Defense budget. This higher number, in large measure, stems from the assumption that outlay rates will be slightly higher from past budget authority than the administration expects them to be.

So there is a discrepancy between CBO and the administration. CBO expects the outlays to be slightly higher, and in the out-years, CBO expects that the Bush budget will represent a decline in real terms because CBO's projection for inflation is higher than the Bush administration's.

Senator BUMPERS. You have a higher expectation of a lower inflation rate?

Dr. REISCHAUER. No. CBO thinks inflation will be higher, so the figures suggested by the administration for their future budget authority—

Senator BUMPERS. I see.

Dr. REISCHAUER [continuing]. Rather than providing 1-percent real growth in 1991 and 1992 and 2-percent real growth after that, may be too low to achieve such real growth, according to CBO's baseline forecast.

Senator BUMPERS. In your \$131 billion forecast for 1990, as opposed to the Bush budget, have you taken that into consideration, that there is going to be a \$2 billion bigger outlay in 1990 than the Bush budget suggests?

Dr. REISCHAUER. That includes CBO's reestimate of outlays from the administration's proposal.

Senator BUMPERS. What is your reestimate?

Dr. REISCHAUER. I think CBO's reestimate is \$3.5 billion higher than the administration's estimate for outlays.

Senator BUMPERS. So about 10 percent of the difference between yours and their budget is in that figure, then, is it not? We are talking about some \$30 billion difference, and you are saying—

Dr. REISCHAUER. There is a \$40 billion difference between CBO's estimate and the administration's budget, and 8 percent—

Senator BUMPERS. Whether it is, I don't—

Dr. REISCHAUER. The answer is that, yes, \$3.5 billion of that \$40 billion is caused by CBO's reestimate; but the \$40 billion is a combination of CBO estimates that are both higher and lower than estimates made by the administration.

Senator BUMPERS. If we were to take that into consideration in this committee in reaching our targets for defense, if we were to take \$3.3-plus billion out of defense, there isn't any reason why we couldn't make up the difference in 1991 and 1992, if necessary. But we could save \$3 billion in 1990, could we not?

Dr. REISCHAUER. I was talking about outlays.

Senator BUMPERS. If we take your assumptions and your projections, we can save \$3 billion next year on defense by providing George Bush with a zero-growth budget in defense. Do you want me to rephrase it?

Dr. REISCHAUER. I do not think that is right. I will check with Jim Blum.

CBO is saying that the administration's budget will entail \$3.5 billion more in outlays than the administration expects. You are going to be voting on budget authority, not on outlays, and most of the outlays that will occur in fiscal year 1990 are the result of budget authority decisions that have been made over the past years.

Senator BUMPERS. You are just simply saying that based on that, you project that outlays will be \$3 billion higher next year than he does?

Dr. REISCHAUER. Right.

Senator BUMPERS. Based on previous authority?

Dr. REISCHAUER. And the authority that will be provided under the President's program in fiscal year 1990, if this committee gave the Bush administration what it requests in budget authority.

Senator BUMPERS. So what we are just saying is that it is not a question of what we are going to do; it is just a question that their assumptions are \$3 billion off, according to your estimates.

Dr. REISCHAUER. Right.

OTHER ESTIMATING DIFFERENCES

Senator BUMPERS. Your \$131 billion, I take it that in arriving at that figure, you did not change anything so far as the programs are concerned in his budget. You just simply reached different conclusions under his current services budget; isn't that correct?

Dr. REISCHAUER. CBO took the President's proposals in as much detail as they were made available and said, under CBO's economic assumptions and CBO's technical assumptions, how much will this result in in outlays and how much will it result in in revenues, the difference being the \$131 billion.

Senator BUMPERS. Let's take ANWR; for example, they assume \$2.1 billion from leasing the Arctic Wildlife Refuge in Alaska. They are including \$2.1 billion in their 1990 budget in revenues. I assume that you just accepted that figure, did you not?

Dr. REISCHAUER. No; we did not.

Senator BUMPERS. Well, how did you deal with that?

Dr. REISCHAUER. That is a technical estimating difference. CBO believes it will be hard to get this leasing accomplished within fiscal year 1990 and have receipts coming in, and the receipts might not be as large as the administration has forecast. CBO's number is \$1.6 billion for 1991 but zero for 1990.

Senator BUMPERS. Is that what you assume in this budget?

Dr. REISCHAUER. The President assumes \$2.1 billion and CBO assumes zero.

Senator BUMPERS. Good for you. You are right on target. We aren't going to get \$2.1 billion unless there is a precipitous rise in oil prices between 1990 and 1991.

No. 2, if we passed the legislation today, they have 9 months to produce regulations or write regulations after enactment, and then the first lease sale is anticipated 18 months after that. So obviously, there is going to be no income in the 1990 budget from ANWR. So I am pleased that you took that out.

How about the super collider? Did you leave their projection in there on the super collider and the nuclear cleanup?

Dr. REISCHAUER. Yes.

Senator BUMPERS. You say that you added \$9 billion because you project less growth and higher interest rates. How much of each one? How much of that \$9 billion, for example, is for your difference in interest rates from this administration?

Dr. REISCHAUER. The answer to that is \$9 billion.

Senator BUMPERS. Oh, it is all in interest, then.

Dr. REISCHAUER. There are some things that go up and some things that go down in all of these estimates. For example, CBO thinks tax receipts, under its own economic assumptions and technical assumptions, will be larger than projected by the administration for personal income taxes, and lower for corporate income taxes.

DIFFERENCES IN REVENUE PROJECTIONS

Senator BUMPERS. That is an interesting proposition. How much difference is there in their projection of personal income taxes for 1990 and your projection?

I am inclined to agree with you; I think revenues are going to be greater next year than they are projecting unless we have a really serious downturn.

Dr. REISCHAUER. We will have to supply that specific number for the record. CBO is projecting that a higher portion of income will be in the form of wages, salaries, and interest payments, which are relatively highly taxed, and expects corporate profits to be lower than the administration does; the corporate tax receipts, therefore, will be below what the administration expects. We will provide you with the exact details.

[The information follows:]

CBO's projection of baseline Federal revenues for 1990 is \$8.6 billion higher than the administration's. CBO's personal income and payroll taxes exceed the administration's by \$14.3 billion. Earnings of the Federal Reserve are expected to be \$2.1 billion higher, as a result of our higher interest rate assumptions. About half of these positive differences are offset by lower corporate income taxes. Because of our projection of lower corporate profits, CBO's corporate tax estimates are \$8.2 billion below the administration's for 1990. Other differences are quite small.

Senator BUMPERS. Did you find any instances where the administration has simply projected, under their current services, a rate of inflation based on the fixed dollars that will be spent this year and that did not take into consideration entitlements where new enrollees might push that number up? Do you follow my question?

Dr. REISCHAUER. Yes; I follow your question. I do not think the Bush administration has yet released a separate set of projections for current services; the ones that are available publicly at this point were prepared by the Reagan administration.

My understanding is that with respect to entitlement programs, which is basically what you are talking about here, the methodology used by OMB is to take account of increases in the caseload—that is, increases in the number of welfare recipients and the number of social security retirees—in an appropriate fashion.

Senator BUMPERS. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Nickles.

Senator NICKLES. Mr. Chairman, thank you very much.

Mr. Reischauer, thank you, as well.

RATE OF INCREASE IN DEFENSE SPENDING

To follow up on maybe one or two things Senator Bumpers mentioned, you are talking about defense spending between 1989 and 1990. Looking at the Bush budget, they show inflation in outlays, and I am talking about outlays, increasing from \$289.8 billion to \$291.2 billion, or an increase of \$1.4 billion, or that would be an increase of one-half of 1 percent, not after inflation, just an increase of one-half percent; is that correct?

Dr. REISCHAUER. That is correct. That is their number.

Senator NICKLES. And you estimate by different spending speeds on budget authority that outlays will actually be about \$3 billion higher than \$291 billion? In other words, \$294 billion; is that correct?

Dr. REISCHAUER. \$294.7 billion.

Senator NICKLES. OK, so an increase of \$3.5 billion or a total increase of \$4.9 billion or, in other words, an increase of about—

Dr. REISCHAUER. 2.2 percent.

Senator NICKLES. 2.2 percent. Not after inflation, an increase between 1989 and 1990 an increase of 2.2 percent; is that correct?

Dr. REISCHAUER. That is not after inflation.

Senator NICKLES. That is correct. Mr. Reischauer, from now on, since I think a lot of times we lose something when we start talking about where this is real, this is nominal and so on, I would encourage you, and the same thing for the administration, to use actual out-of-pocket dollar figures. I think it keeps everybody on the same plane and you don't have to try and factor in in your mind what inflation levels are. "Well, this is a real reduction after inflation" and so on, and we just say, OK, defense would be, under the Bush proposal or estimate, defense would increase \$1.4 billion, and you estimate that it is going to increase about \$4.9 billion, and that is just the difference in spendout rates on budget authority, and I think that is fine.

Estimates are that inflation is increasing next year at, what, 4. something?

Dr. REISCHAUER. Yes, 4.1 percent.

Senator NICKLES. So actually, defense outlays will be increasing significantly less than inflation rate as well as budget authority will be increasing less than inflation rate? Is that correct, in defense?

Dr. REISCHAUER. The first half of the statement is correct. The second half—

Senator NICKLES. Let me look at the budget authority. I see the budget authority increasing \$9 billion. Under their proposal, if inflation is increasing at 4.4 percent, that would be a \$12 billion increase, so it is less than \$12 billion.

Dr. REISCHAUER. An adjustment is being made within the defense budget that is connected with the accrual charges for the military retirement system; the actuaries have changed the assumptions for their calculations, and this has provided a reduction.

Senator NICKLES. I don't want to spend all my time on defense. I just wanted to make the point that defense spending was increasing at a lower rate than what some people would perceive.

Dr. REISCHAUER. Defense outlays are increasing slowly relative to inflation because real budget authority was reduced in decisions made over the last 4 years.

Senator NICKLES. I am aware of that. Let me ask you a question. What percent of the defense budget is personnel; do you know? If you don't know it, that is OK.

Dr. REISCHAUER. Roughly 25 percent.

Senator NICKLES. I think it is higher than that, but let's leave that open and maybe you can supply that for us. It would be helpful.

The CHAIRMAN. Would you supply that for us?

Dr. REISCHAUER. Yes, we will.

[The information follows:]

Military pay and allowances make up about 25 percent of the defense budget. If civilian pay is also considered, then about 38 percent of the defense budget is for personnel. Until recently, the Department of Defense provided estimates of additional costs, such as medical care, that could be considered personnel costs. Considering this third set of costs would raise personnel costs to over 40 percent of the defense budget.

INCREASES IN DEFICIT SINCE OCTOBER 1988

Senator NICKLES. I appreciate that. I wanted to visit with you, for a second, because you estimate that the deficit will be what in 1989, in the year we are in right now?

Dr. REISCHAUER. \$159 billion, not taking account of changes that might be made by Bush administration suggestions that affect the current fiscal year or any changes that the Congress might want to make.

Senator NICKLES. I just made a speech on the floor on OMB. The estimates in October were \$146 billion; the estimates in February were \$163 billion. Of course, it is always subject to change, but that is an increase of \$17 billion.

I did a little home work on it and found that \$11 billion of that was increased interest expense, and \$11 billion of it was FSLIC, and they estimated a \$5 billion increase in revenue, so the net would be an increase in the deficit of \$17 billion. That was between October and February. That \$163 billion, I understand, is subject to change. This is March, that was February, and it may change, but it has gone up about \$17 billion, mostly because of interest expense, because the FSLIC, the increased cost of FSLIC is due to interest expense.

I tell this to my colleagues. I am very concerned about actions that the Federal Reserve has taken. I am very concerned that they may be shooting a hole in this budget or making it impossible or very much more difficult for those of us on the Appropriations and the Budget Committee to do our job.

Increased interest expense, that is the main difference, as I can see it, between your projections, which you are projecting now a deficit in 1990, instead of \$90-some billion as proposed by the administration, \$130 billion. Most of that is interest. You mentioned \$9 billion in response to Senator Bumpers' question, and then you mentioned the FSLIC cost and whether it would be on budget or off budget. But the increased cost of FSLIC is due to higher interest assumptions.

Dr. REISCHAUER. Much of the increased cost is due to the fact that the administration has proposed that we resolve this problem.

Senator NICKLES. I understand.

Dr. REISCHAUER. Some of that is interest cost, but most of it is expenditures to close failing institutions.

EFFECT OF INTEREST RATES ON THE DEFICIT

Senator NICKLES. For every percentage point of interest expense increase, if short-term T bill rates go up a point, what does that cost or increase the deficit?

Dr. REISCHAUER. If interest rates went up on January of this year by 1 percentage point, the increase in the 1990 deficit would be \$11 billion.

Senator NICKLES. I understand. That is all interest rates, all maturities.

Dr. REISCHAUER. All maturities.

Senator BUMPERS. This year? Are you talking about 1989, Mr. Reischauer?

Senator NICKLES. Heading for a full year.

Dr. REISCHAUER. If on January 1, 1989, interest rates suddenly jumped 1 percentage point, what impact would that have on the fiscal year 1990 budget? The answer is \$11 billion. It would be roughly \$29 billion 5 years from now.

Senator NICKLES. Could you give me that answer in short-term rates? Because as you know, we have had a real jump in short-term rates. Short-term T-bill rates today are 3.5 percentage points greater than what they were a year ago. The long-term rates are about 1 point greater.

Either way, you realize that the Federal Government is going to be paying a lot more for interest; net interest expense is going to rise dramatically. That is the biggest difference, as I can see, taking out the FSLIC case, the difference between your assumptions and the Bush administration's, and certainly, if the Federal Reserve continues their policies, CBO is going to be closer to the mark.

Because you are looking at short-term T-bill rates right now a little bit less than 9 percent. The Bush administration has estimated they will be 5.5. You came down the middle at 7.1.

Well, last year they were 5.5. They can be 5.5 again, but they are not going to be 5.5 if the Federal Reserve constricts the monetary supply in their efforts to slow down the growth of the economy in their efforts to slow down inflation.

So I guess my concern is that the Fed is taking some actions which you are reflecting to some extent, and the administration, I know, is hopefully becoming, I would hope, aware of it, because I think they are really torpedoing the budget that we are working on. If you had short-term rates increase and stay at 3.5 percentage points higher, how much of an increase in the deficit or how much increase in the interest expense category would that be?

Dr. REISCHAUER. If on January 1 interest rates on short maturities went up by 3.5 percentage points and long-term rates did not change at all, the fiscal year 1990 deficit would increase about \$20 billion. It is about \$6 billion a point for—

Senator NICKLES. Short-term?

Dr. REISCHAUER [continuing]. Maturities, and as you pointed out, the long-term rates have not changed all that much. The action has been in short-term rates.

Senator NICKLES. About 0.8 percent, so it has been a significant hit. That is about \$8 billion. But the short-term rates is where it has been a really an appreciable move, and I really think that is a very significant and serious problem. You factored in about half of it, and you may well be on track. It kind of depends on what the Fed does.

Dr. REISCHAUER. CBO still stands behind its current projections. At the moment, we are slightly low for the short-term rates and probably slightly high for the long-term rates.

SURPLUSES IN TRUST FUNDS

Senator NICKLES. One quick question. I am almost out of time. What is the total surplus of monies going into the trust funds? What is that figure?

Dr. REISCHAUER. For 1990, it is almost \$70 billion.

Senator NICKLES. Could you give us a breakdown of each one of those trust funds for the record?

Senator BUMPERS. That gets interesting, Mr. Chairman. If you would yield for a question, let him just do that quickly. They can get the interest. I would like to know what all three of those numbers are. You have social security, airports, and highways.

Senator NICKLES. And Medicare.

Dr. REISCHAUER. And Medicare.

Senator NICKLES. And black lung.

Dr. REISCHAUER. Civil service retirement, military retirement. I gave you an incorrect number. I gave you just the social security system surplus.

Senator NICKLES. I think it is closer to \$100.

Dr. REISCHAUER. Yes, I think you are right. Old-Age, Survivors, and Disability Insurance is roughly \$70 billion. On another point, the fraction of the military budget that is devoted to pay benefits and related items is about 40 percent, so you were right on that. This number includes the civilian workforce of DOD; the 25 percent figure was limited to military personnel.

Senator NICKLES. Thank you.

The CHAIRMAN. You will supply those figures for the various categories for the record?

Dr. REISCHAUER. Yes, Mr. Chairman.

[The information follows:]

TRUST FUND SURPLUSES IN THE CBO BASELINE

[By fiscal year, in billions of dollars]

	1989	1990	1991	1992	1993	1994	Holdings, 1994
Social security.....	56	68	79	90	103	117	618
Medicare.....	20	23	21	19	17	15	188
Military retirement.....	15	14	15	15	15	16	131
Civilian retirement ¹	21	21	23	25	26	28	343
Unemployment.....	9	7	6	4	3	3	68
Highway and airport.....	3	2	1	1	1	1	35
Other ²	-1	1	(³)	(³)	(³)	-1	53
Total trust fund surplus.....	122	136	145	154	166	179	1,436
Federal funds deficit.....	-281	-282	-292	-294	-301	-309	
Total deficit.....	-159	-146	-146	-140	-135	-130	

¹ Civil Service Retirement, Foreign Service Retirement, and several smaller retirement funds.

² Primarily Railroad Retirement, employees' health and life insurance, Superfund, various veterans' trust funds, Federal Deposit Insurance Corporation, and the Foreign Military Sales Trust Fund.

³ Less than \$500 million.

Senator NICKLES. Mr. Chairman, thank you.

The CHAIRMAN. Senator Adams.

MARGINAL BUDGETING IN PRESIDENT'S PROPOSALS

Senator ADAMS. Thank you very much, Mr. Chairman.

Mr. Reischauer, congratulations, I think, on your new position. Mr. Reischauer, I want to ask you a fundamental question on the two different approaches that are being used by the President's budget proposition and what we have used traditionally in the CBO and the Congress, what was traditionally used by OMB.

When we started this process of CBO, we used a series of straight baseline figures based on past experience. We used assumption lines. Moving out from those, we used outlay lines moving from those, and then we crosswalked back into the committees so that we had a picture of the past, and basically straight-line projections for the future; isn't that correct?

Dr. REISCHAUER. Correct.

Senator ADAMS. Now, what has been done in the budget proposal, the political proposal made by the President, is to say an entirely different thing. It is to say that we will have an \$82 billion growth in revenues and that we will divide this \$82 billion through a series of proposals. In other words, it starts from the revenue end and works back to divide. It is marginal budgeting.

Could you compare for me, because you compared, and I see in your testimony that if you take REFCORP off and you don't exclude asset sales, you are within \$9 billion. Now, \$9 billion in \$1 trillion budget is something that we can handle. This \$9 billion is the difference between their budget and your budget using the assumptions that we have used, if you take REFCORP out and you take out asset sales. This is in your chart I.

Dr. REISCHAUER. The difference is \$18 billion. CBO estimates the deficit will be \$109 billion; the administration estimates it will be \$91 billion.

Senator ADAMS. That is right, and the target is \$100, I'm sorry.

Dr. REISCHAUER. Yes, the target is \$100 billion.

Senator ADAMS. So you are within \$9 billion of the target above, and they are below. Now, using the traditional approach with REFCORP and asset sales in, we are \$131. I was using \$131.

Dr. REISCHAUER. Correct.

Senator ADAMS. Now, I just want you to compare for me and you can tell the committee, do you think the \$82 billion marginal budgeting approach is valid? That is one. And second, if we applied it to our traditional approach here—because otherwise, if we don't do this in some fashion, we are going to be talking apples and oranges all year—where do we come out with that kind of a spread sheet proposal for both appropriating and for our entitlement programs?

If that is so hard a question you would like to submit something in writing, I am very pleased to receive it in writing, but I would like your general impression and then you can fudge on it any way you want.

We have had two very different budget systems in operation here, and at least this committee is going to have to deal with that.

Dr. REISCHAUER. Yes; going down that line of questioning, I thought my first week here might be my last.

Senator ADAMS. I tried to give you an out. You can answer both ways.

FLEXIBILITY IN ADMINISTRATION'S STATED APPROACH TO BUDGET

Dr. REISCHAUER. The administration has suggested that we should discard the current services or current policy approach to budgeting, which estimates how much would be spent next year if we adjusted discretionary programs for inflation, if we allowed the—

Senator ADAMS. You build from a base and project.

Dr. REISCHAUER. The administration, however, did not adhere to that stated principle in the rest of the document that it provided, and, therefore, I presume that even the OMB allows some flexibility on the presentation of these decisions to the Congress and to the American people.

If revenues increased \$82 billion and we assumed that amount would be available for increased budget authority or outlays in the coming year, and if entitlement programs were allowed to grow as they would unless we changed existing law, this committee would be left with few added resources to increase budget authority for the fiscal year 1990 budget.

Senator ADAMS. We couldn't cover the proposals that he has made in the "Building a Better America," could we? That is really the question I am asking you. He allocates, he says: Let's look at this upside down. We take \$82 billion; we will set aside this amount for deficit reduction to meet the target; then list a series of programs that we would fund.

What I am asking you is: I, obviously, can't add in my head and go back and forth through 1,001 budget line items and say whether that is possible. I am asking you whether you, CBO, has made an analysis, and is it possible?

Because he had a series of specific proposals that will be placed as either appropriation items or——

MATCHING REVENUE GROWTH TO OUTLAYS

Dr. REISCHAUER. You are asking whether the budget authority and resulting outlays from the President's positive proposals exceeds the \$82 billion in revenues?

Senator ADAMS. Yes; does it fit?

Dr. REISCHAUER. But the President has also suggested a number of reductions. The net figure would have to be calculated.

Senator ADAMS. Right. Does this \$82 billion proposal and your table 1, which gives the administration estimates and your comparison, do they match?

Dr. REISCHAUER. I do not know the answer to that. CBO will provide something for the record.

Senator ADAMS. Would you please submit that in writing to the chairman and the members of the committee?

Dr. REISCHAUER. Yes.

[The information follows:]

*Demands on projected revenue growth, fiscal year 1990**(In billions of dollars)*

Growth in revenues	86
Demands on revenue growth:	
Deficit reduction ¹	59
Current law increase in entitlements and offsetting receipts	34
Increase in outlays from prior budget authority	10
Increase in interest costs ²	11
Total	114

¹ Assumes that the deficit is reduced from its 1989 baseline level of \$159 billion to the 1990 target of \$100 billion.

² Assumes a 1990 deficit of \$100 billion.

Senator ADAMS. Because I don't want to be talking off of two sheets. I understand a lot better, just like the boy who had to write the report on penguins, I know a lot more about budgeting in the CBO than I really want to know. I am prepared to work off of that system.

But if we are receiving proposals, which we will be receiving, based upon an \$82 billion revenue proposed increase, and I have you at, first, in your reply, in your written reply, give whether you think that is accurate, and since you state in here you feel that your tax receipts will probably be higher than the administration.

Dr. REISCHAUER. More than \$82 billion.

Senator ADAMS. That is because of the cost of inflation, probably. So if they have \$82 billion, it is probably somewhat valid. Then I would like to have you take out the items that he has here and the entitlements and run it into his chart on table 1, in other words, in the traditional chart, which I think you can do.

Because then we will get the black box taken apart, and it will no longer be a black box. It may be a cube, one of the unsolvable cubes, but it will show the committee each time so that we are not being told politically that we have thrown out a program that could be afforded under the \$82 billion when really, we couldn't afford it at all unless we did away with x number of programs first.

You see the three levels that I would like to have you present? Revenue level; what we will be spending; then the programs that he has and what we have to drop to meet those programs. I am assuming in that that we meet Gramm-Rudman-Hollings, which is what he assumes.

Dr. REISCHAUER. Yes.

Senator ADAMS. I don't think he meets \$91 billion with this thing. I am not trying to trap you in any way, Mr. Reischauer. I just don't think he meets \$91 billion with this package under any kind of budgeting that we all understand and work from.

If he does, then we have got to crosswalk into that and answer each time that we either did or didn't meet the program.

Dr. REISCHAUER. CBO's estimate of the year-over-year increase in baseline revenues that will result from the President's budget is \$86 billion, his number plus \$4 billion.

[The information follows:]

CBO's projection of baseline Federal revenues for 1990 is \$8.6 billion higher than the administration's. CBO's personal income and payroll taxes exceed the administration's by \$14.3 billion. Earnings of the Federal Reserve are expected to be \$2.1 billion higher, as a result of our higher interest rate assumptions. About half of these positive differences are offset by lower corporate income taxes. Because of our

projection of lower corporate profits, CBO's corporate tax estimates are \$8.2 billion below the administration's for 1990. Other differences are quite small.

Assuming the administration's revenue proposals are enacted, CBO's total revenue estimate is \$6.7 billion above the administration's. The administration estimates that their several proposals, taken together, will raise revenues \$5.6 billion above baseline levels. CBO disagrees, primarily about the result of the proposal to reduce the capital gains tax rate. We estimate the proposals will raise only \$3.7 billion in additional revenues. The \$1.9 billion less in revenue gain from proposed changes somewhat offsets the \$8.6 billion gap in baseline revenues, putting CBO's estimate of proposed budget revenues \$6.7 billion above the administration's figures. As at baseline levels, CBO's personal tax estimate is higher—by \$12.1 billion in the individual income tax and \$0.8 billion in social insurance taxes. Estimates of Federal Reserve earnings are \$2.1 billion higher (they are unaffected by the proposals). CBO's estimate for corporate income taxes remains \$8.2 billion below the administration's, the same difference as under baseline assumptions, since CBO and the administration expect similar results from the revenue proposals affecting corporations.

Dr. REISCHAUER. Against that, we will have to balance CBO's projections for the baseline growth in entitlements and interest payments, which is about \$50 billion. To reach the Gramm-Rudman-Hollings target of \$100 billion from CBO's current estimate of the deficit, which is \$159 billion for this year, there must be an adjustment of \$59 billion.

Senator ADAMS. Fifty-nine? You have got to get out of that.

Dr. REISCHAUER. So the sum of these two will be \$109 billion of demands versus \$86 billion of revenue growth.

Senator ADAMS. So we are short.

Dr. REISCHAUER. But only on a current policy basis. We have not accounted for the administration's requested positives or negatives.

Senator ADAMS. That is what I wanted to know.

Dr. REISCHAUER. That is what we will provide for the record.

[The information follows:]

Demands on projected revenue growth, fiscal year 1990

[In billions of dollars]

Growth in revenues	86
Demands on revenue growth:	
Deficit reduction ¹	59
Current law increase in entitlements and offsetting receipts	34
Increase in outlays from prior budget authority	10
Increase in interest costs ²	11
Total	114

¹ Assumes that the deficit is reduced from its 1989 baseline level of \$159 billion to the 1990 target of \$100 billion.

² Assumes a 1990 deficit of \$100 billion.

Senator ADAMS. That is what I need to know, because that is what I suspected, was that the \$86 billion or \$82 billion that he puts in here, after you take out the entitlements and after you take out the deficit reduction, you are at \$109 billion, and you take the \$86 from that, that means that we have got to cut \$23 billion worth of programs before we fund anything in here.

Dr. REISCHAUER. Yes.

Senator ADAMS. Net.

Mr. Chairman, I just wanted to make the point that I think we are in a very deep hole. Thank you.

The CHAIRMAN. Thank you, Senator Adams.

Senator Cochran.

ECONOMIC IMPACT OF DEFICIT

Senator COCHRAN. Mr. Chairman, this may be irrelevant, but I am curious as to our witness' impression of the economic impact of the deficit that we face this year. In the context of our overall financial condition as a nation or as a government, however you want to look at it, we develop this budget, which is primarily an itemization of annual expenditures and annual projected receipts. However, we don't, when we present this budget, differentiate, as I understand it, between kinds of expenditures.

I wonder if we could develop a different kind of presentation which would reflect the nature of the expenditure as one of customarily understood annual expenses that once spent were gone or one of that type of expenditures that amount to investments, such as acquisition of property, building buildings, and defense systems that had a life longer than 1 year. Would our budget look any different or have any different impact on our perception as to whether we are economically in good shape and financially sound or whether we need, for example, to look for some way to increase revenues to bring that budget into better balance?

What is your reaction to that kind of inquiry?

Dr. REISCHAUER. That is a very important issue. How concerned we should be about the deficit depends on many things, one of them being what is causing the deficit. If the deficits of the past few years were attributable in large measure to a rebuilding of the public capital stock in America, a tremendous surge in public investment, or even a large increase in human capital spending, such as investment in education from which we expect to reap gains in productivity and living standards in the future, one would be much less concerned about the deficit than if one found that the growth in the deficit were attributable largely to current government consumption, wages and salaries for government employees, various day-to-day expenses, and miscellaneous transfer payments.

The composition of spending since 1980 or 1981 hardly shows a surge in public investment. Only in defense procurement where one can regard certain kinds of weapon systems or long-lived assets in the military as investments is this the case. The useful life of these kinds of investments is difficult to determine. Technology can render a weapon system worthless in a week.

We should, in any case, be very concerned about a deficit of \$159 billion, and we should take steps to reduce it, because there is no strong evidence that this deficit has been associated with a surge of public investment.

EFFECT OF CONGRESSIONAL BUDGET ACT OF 1974 ON DEFICIT

Senator COCHRAN. In your observation over the last several years, can you point to anything in the Budget Control and Impoundment Act that was passed back when Senator Adams and I were Members of the other body that has contributed to reducing the deficit?

Dr. REISCHAUER. Changes in the budget process?

Senator COCHRAN. Any provisions that are in the Budget Control and Impoundment Act that was passed whenever it was, 197—

Senator ADAMS. Four.

Senator COCHRAN [continuing]. Four that has contributed to reducing the deficit?

Dr. REISCHAUER. Personally, I believe the Gramm-Rudman-Hollings legislation has had a substantial impact on the way this body and the House operate and has held the deficit down. I think that also the Congressional Budget Act that was passed in 1974, which first brought me to the Hill in February 1975—

Senator COCHRAN. That is the one we are really referring to, is the 1974 Act.

Dr. REISCHAUER. By itself?

Senator COCHRAN. Yes.

Dr. REISCHAUER. I will amend my answer. The general effect of the act has been to restrain spending and deficits, and to make the Congress more aware of its decisions. Before that time, there was no way of scrutinizing budget aggregates. The Congress had no committees to rationalize spending and revenues and to draw attention to imbalances. Provisions within that law, as Senator Adams knows, restricted backdoor spending. Those provisions have probably been responsible for the virtual elimination of backdoor spending increases.

Senator ADAMS. Would the gentleman yield for one quick question?

Senator COCHRAN. I am happy to yield to the Senator.

Senator ADAMS. Didn't the actions in 1980 and 1981, where we had those continuing resolutions really smash the budget process for those 2 or 3 years?

Dr. REISCHAUER. Are you going to let me submit that for the record, too? [Laughter.]

Senator ADAMS. Yes, you can. Thank you.

Dr. REISCHAUER. No, I don't think the budget process has been smashed at any time.

TIME CONSTRAINTS IN BUDGET PROCESS

Senator COCHRAN. Hasn't the budget process smashed the appropriations process [laughter] by permitting—

Dr. REISCHAUER. Now I am getting one-on-one.

Senator COCHRAN [continuing]. By permitting so little time for this committee to consider its options under a budget resolution. In those years, when no budget resolution was ever agreed to, as required by the Budget Act or was agreed to so late in the year that there was really no time left for the committee to carefully consider its options as defined by the categories that were provided for in that resolution?

Dr. REISCHAUER. It is unarguable that the existence of the budget process has put time constraints and hurdles in the way of this committee, largely because we are in a period of disequilibrium. We have large deficits that are viewed by the vast majority of members as too large; they have to be brought down. If, for example, we had a deficit of \$10 or \$15 billion, I think the budget process would be much smoother and this committee would have much more time to do the very important work that it is charged with.

Senator COCHRAN. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

The House is able to proceed with appropriation bills, I believe, following May 15 regardless of whether or not the budget resolution has been adopted.

Over here, a point of order can be made against any appropriations bill brought up prior to the enactment of the budget resolution. So if the Senate would do as the House did, would that help the appropriations process insofar as the Senate is concerned?

The Senate is at a disadvantage as compared to the House in that respect. Do you have any comment?

Dr. REISCHAUER. I am not going to involve myself in Senate procedures. There is more expertise in this room on the other side of the table than on this side.

Senator ADAMS. Mr. Chairman?

The CHAIRMAN. Senator Fowler?

Senator FOWLER. Mr. Chairman, I just came in. I want to invoke my own rules. Since I was late, I yield to Senator Kerrey.

The CHAIRMAN. Senator Kerrey.

Senator KERREY. Thank you, Senator Fowler, Mr. Chairman. That was very nice.

I like the context within which Senator Cochran asked questions. He demonstrated, it seems to me, a deep sensitivity to the problems the deficit creates for the American people and the impact it has upon them.

SHOULD RECORD BE ON- OR OFF-BUDGET

I have some concerns about what is presented in your testimony as understandably so, I think, an academic argument—about REFCORP being on- or off-budget.

Earlier, we heard Secretary Brady explain the details of this plan, and the chairman of this committee asked, I think, a number of relevant questions about REFCORP and suggested that it be kept on budget for the purposes of improving accountability. It seems to me that the American people are going to require that as a policy matter.

I am still trying to sort out, not just the policy, but I am still trying to figure out how the cash flows in this deal. Do the increased fees that are being charged, do those fees flow into REFCORP, or do they flow into the General Treasury?

Dr. REISCHAUER. Before I address that problem, let me say a few words about your opening sentences, because confusion exists about whether REFCORP should be on-budget or off-budget, as distinct from whether it should be counted for Gramm-Rudman purposes or not.

We have certain items that are off-budget, but which are counted for Gramm-Rudman; namely, social security. We also have certain items that are on-budget; namely, asset sales, which are not counted for Gramm-Rudman purposes.

Whether REFCORP is on-budget or off-budget is one issue; whether it is counted for Gramm-Rudman purposes or not is another. If it were on-budget, it would help make the unified budget comprehensible; there is also the issue of accountability.

Let me turn to Jim Blum to answer your specific question.

Senator KERREY. Let me just follow on your explanation. It seems to me that the man on the street would look at it and say, "We have got social security on budget because it"—

Dr. REISCHAUER. It is off-budget.

Senator KERREY. Social security is in the unified budget because it reduces the deficit, and REFCORP, we are going to put outside the unified budget because it has the potential of increasing the deficit. Am I missing some details here?

Dr. REISCHAUER. The concept of a unified budget was brought about in 1969 when social security and other entitlements were brought into the budget. Since the Gramm-Rudman-Hollings Act took social security off the budget, I am not sure that the definition for a unified budget has much meaning anymore.

Mr. BLUM. Senator, you asked what happens to the increased assessments that would be levied. Under the administration's plan, the largest of those assessments are on the banks and would be targeted for the Federal Deposit Insurance Corporation Fund. As cash coming into the Government, they would reside in the general fund of the Treasury and would reduce the deficit if they were not used by the FDIC.

Senator KERREY. They will show up as increased revenue.

Mr. BLUM. That is correct. There are, in the administration's plan, also proposals to increase the assessments on the savings and loans institutions, but not until 1991, if I recall correctly, and the increase is very small. It would not produce many additional revenues.

PROBLEMS WITH OFF-BUDGET ACCOUNTS

Senator KERREY. I like your comment. It just seems to me that the miracle innovation that is displayed in this plan—and I must confess, the numbers turn me upside down—but the miracle innovation would, perhaps, lead the disingenuous soul to suggest that perhaps we should take the entire budget and move it off-budget through such a mechanism as this.

Perhaps we can eliminate taxes altogether with these sorts of mechanisms. I find myself, because I have been challenged on many occasions when I said, "It seems to me that our children need greater care and our seniors need greater care." I have been challenged, "Well, how are you going to pay for it?"

Here we have a proposal that causes me to conclude that the next time I come up with a program or proposal, I can call the folks who developed this plan and ask them if they can put together something similar for me so that I can magically spend \$157 billion, which proximates, in real dollars, the Marshall Plan, but which actually appears to reduce the deficit.

It seems to me that on the basis of policy, that it could be a rather unfortunate precedent. I genuinely urge you to pick apart anything I am saying here. If you think I am acting the fool, say so.

Mr. BLUM. No, not at all. Actually, the administration's proposal for raising \$50 billion through the Resolution Financing Corporation in the manner in which they have laid it out would have an off-budget entity in their terms raising the \$50 billion, turning that

money over to the Government and counting those proceeds as offsetting collections or like revenues.

Clearly, this is Government borrowing, and in normal accounting, all the Government borrowing does not count as an offset in collection or a revenue. If it did, we would have no deficit problem. So this is clearly an anomalous method.

Senator KERREY. But it clearly will be, if I represent that the fees being charged are something that will increase revenue to the Government. Am I representing it correctly?

Mr. BLUM. That is true. The increased fees, primarily on the banks, would have the effect of reducing the Federal deficit, provided that they are not used by the FDIC.

Senator KERREY. But can you also see how I could design something like this for education, for health care, for child care. We can design all kinds of fees to cover malfeasance bonds that we then sell in the marketplace to pay for something we want to buy.

Mr. BLUM. You are absolutely correct, Senator. This kind of proposal to set up yet another Government-sponsored enterprise off-budget sets a dangerous precedent for similar proposals in other areas.

The CHAIRMAN. Thank you, Senator Kerrey.

Senator Fowler?

Senator FOWLER. Thank you, Mr. Chairman.

NEW SPENDING AND FLEXIBLE FREEZE IN PRESIDENT'S BUDGET

Mr. Director, I tried to swiftly read your testimony but failed, so let me just ask you a couple of things. I wanted to get some figures back in my mind. How much in new spending has the administration proposed?

Dr. REISCHAUER. I am not sure I have that. You are talking about positive increases, excluding the cutbacks that have been proposed?

Senator FOWLER. Right. He announced to us he wants to build a space station; we want to be the education President; we are going to clean up the oceans. How much over current fiscal year spending has he proposed in new spending in the aggregate?

If you don't want to give me a ballpark figure, you can send us a reply.

Dr. REISCHAUER. The figure for discretionary accounts is \$3.8 billion, but that is an outlay number. There are other items which would be left out.

Senator FOWLER. Right. If you would just supply us with that, I would appreciate it.

Dr. REISCHAUER. Fine.

[The information follows:]

*Proposed spending increases in Bush budget, fiscal year 1990**(In billions of dollars)*

National defense.....	0.7
Nondefense discretionary spending:	
International affairs.....	.5
Science and space.....	1.2
Transportation.....	.3
Census.....	.8
Education.....	.2
Health.....	.5
Administration of justice.....	.3
Other.....	.1
Subtotal.....	3.8
Entitlements and other mandatory spending:	
Deposit insurance.....	12.8
Child care credit.....	.3
Subtotal.....	13.1
Total.....	17.6

Senator FOWLER. How much do you calculate the administration's flexible freeze will save over this year's outlays, if we adopt the President's plan.

Dr. REISCHAUER. The application of the flexible freeze appeared to be concentrated on this group of programs that——

Senator FOWLER. \$136 billion.

Dr. REISCHAUER [continuing]. That is \$136 billion, and CBO estimates that that group of programs was reduced by \$9 billion from our current policy estimates of what those programs would cost in fiscal year 1990. But it is a zero increase from 1989. The President is saying those programs spent \$136 billion or will spend \$136 billion in 1989, and we are going to keep them in the aggregate at \$136 billion in 1990.

Senator FOWLER. Right.

Dr. REISCHAUER. CBO expects those programs to grow to \$145 billion under a current policy assumption.

Senator FOWLER. There is approximately \$1 trillion, I understand, that is not a part, under his plan, of any flexible freeze.

Dr. REISCHAUER. That is true. In some of those areas, he is suggesting pluses, and in others he is suggesting minuses.

SAVINGS UNDER ONE-YEAR FREEZE WITH NO ADJUSTMENT FOR INFLATION

Senator FOWLER. Another ballpark figure, but if the Government froze everything in place, the Fowler freeze, solely for the sake of questioning, and I am not being an advocate, but I will define it for you. Despite all of our semantics, that simply means that no government entity spends more money than they had last year, no inflation, no real dollars versus unreal dollars; no 1990 dollars versus 1973 dollars; something all us common folks can understand; you are going to get the same as you got last year for 1 year, and if that were applied, governmentwide, including social security before you ask me, as well as the military, everything, how much money would that entail? How much money would we save?

Dr. REISCHAUER. CBO is an agency that looks forward, so when you ask us what the world looks like now, we cannot answer the

question. CBO expects outlays in 1989 to be \$1,141 billion, and so that is what they would be under your hypothetical freeze in 1990.

Senator FOWLER. Wait a minute. No, the increase. You are freezing at last year's levels. You wouldn't save that much money.

Dr. REISCHAUER. No, this is not the savings, this is the total amount.

Senator FOWLER. I want to know how much is saved if we froze everything for 1 year; everybody has to do with what they had last year, no more, no less. It seems like a reasonable enunciation of the question. I am not advocating policy.

Dr. REISCHAUER. \$201 billion.

Senator FOWLER. \$201 billion with a total freeze for 1 year.

Dr. REISCHAUER. Excuse me.

Mr. BLUM. Our current estimate, Senator, for outlays in 1989 is \$1,142 billion. Under our baseline projections for 1990, that would rise to \$1,215 billion.

Dr. REISCHAUER. Seventy billion dollars.

Mr. BLUM. So the savings would be \$73 billion.

COST OF HIGHER INTEREST RATES

Senator FOWLER. That seems more like it. Let's discuss the interest. One more thing, Mr. Chairman. I know my time has expired. If, as so many of our one-armed economists are predicting—You remember the old saw from President Johnson, "Lord send us the one-armed economist because 'on the one hand, on the other hand.' "

But if the one hand is that interest rates go to 12 percent the next 2 or 3 months, at 12 percent, how much increase in the interest payment on the debt is that going to cost us? Have you got any slide rules there that can tell us that?

Dr. REISCHAUER. It would probably be an increase in interest rates over what we are projecting of roughly 3 percent, and that would result in roughly a \$30 to \$35 billion increase in the deficit.

Senator FOWLER. We are assuming that interest rates are rising.

Dr. REISCHAUER. If all interest rates are rising; if long-term, short-term, everything is rising.

Senator FOWLER. Right, but I am assuming, is it 10½ now? Is prime at 10½?

Dr. REISCHAUER. The prime rate is at 10½ percent, but the Federal Government borrows between 3- and 30-year maturities.

Senator FOWLER. Right.

Dr. REISCHAUER. The short-term rates are now down around 8.7 percent, and the long-term rates up around 9½.

Senator FOWLER. I understand that. All I am asking is just whether again, you can figure what the Government rate is going to be, approximately, off of the prime, can you not?

Dr. REISCHAUER. Fairly accurately, yes.

Senator FOWLER. So the interest rate is 10½ now. If the prime is at 10½, just to get us out of the security market for a second, if the prime is at 10½ now—

Dr. REISCHAUER. It is at 11½ percent now.

Senator FOWLER. All right. Let's say it goes to 13. That is going to be 30. If it goes up 1½ points, that is going to be \$30 to \$35 bil-

lion, is it not, in increased interest costs, whatever our figure is, on our interest cost on the debt?

Dr. REISCHAUER. If the increase in the prime rate of 1½ percent led to a 1½-percent increase in all maturities of Federal borrowing, we would see an increase of around \$17 billion. If it only affected short-term rates, we would see a \$9 billion increase in the deficit or in interest expenditures.

Senator FOWLER. OK.

Mr. Chairman, thank you.

The CHAIRMAN. Thank you, Senator Fowler.

COST OF PRESIDENT'S S&L PROPOSAL

Dr. Reischauer, in Mr. Brady's testimony earlier this week, we attempted to determine the full 33-year cost of the administration's proposal to resolve the savings and loan crisis.

A portion of the administration's plan deals with the resolution of around 350 insolvent S&L's that are still open. Mr. Brady testified that the overall effect of this part of the administration's plan on the Treasury would be \$39.9 billion over the next 10 years.

I believe that CBO has calculated the cost to the Treasury for this portion of the administration's plan to be \$84 billion for 10 years; is that right?

Dr. REISCHAUER. Correct.

The Chairman. Is the \$39.9 billion outlays figure a true measure of the Treasury funds that would be required under the administration's plan for the first 10 years?

Dr. REISCHAUER. Under CBO's calculations, no. The administration's \$39 billion estimate includes about \$20 billion in additional collections to FDIC, which are reserved for the banks as opposed to the savings and loans industry. So that estimate contains incompatible numbers.

Mr. BLUM. I might add, if I may, Mr. Chairman, that the administration's numbers focused on their estimate of the net budget impact, which takes into account the FDIC assessments as well as other measures that they would incorporate in their budget estimates.

Shifting the focus to the cash that would have to be expended over this period, CBO would come to a different conclusion. The Treasury would have to produce about \$84 billion in cash over this period between now and 1999.

The Chairman. Has CBO calculated the full 33-year cost to the Treasury for this portion of the administration's proposal?

Mr. BLUM. Yes, Mr. Chairman. If we extend the projection by adding the numbers year-after-year, the figure approaches \$150 billion.

The Chairman. \$150 billion.

Mr. BLUM. Approaching that. It would actually be about \$147 billion.

The Chairman. Mr. Brady said it would be \$94.1 billion.

Mr. BLUM. He was just looking at the Treasury funds. This is setting aside the monies that would also contribute to the cost by the Federal Home Loan banks and the use of various receivership

funds that come in from liquidating closed savings and loans institutions.

If we look only at Treasury funds, Mr. Brady's estimate was \$94 billion, and CBO's comparable estimate would be \$126 billion, using our interest rate assumptions and other similar measures.

The CHAIRMAN. What causes that increase of something like \$32 billion, \$31 billion?

Mr. BLUM. That is right.

— REASONS FOR CBO'S HIGHER COST ESTIMATE

The CHAIRMAN. What caused that increase?

Mr. BLUM. Two things, primarily. One is that, as has been pointed out earlier this morning, CBO assumes that interest rates are going to be higher in the near term at the time that this borrowing takes place. So that accounts for a large part of this difference.

Second, we think that the markets are going to charge higher premiums on this borrowing if it is made by an off-budget entity or a new corporation, as proposed by the administration. The Secretary of Treasury, in his estimates, assumes that the premium would be about 25 basis points. The estimates made on Wall Street and elsewhere would indicate that the premium would be more in the range of 30 to 40 basis points.

The CHAIRMAN. The administration calculates the cost of their proposal to the Treasury to be roughly 31.6 percent. What percent of their plan do you estimate that Treasury will pay?

Mr. BLUM. When CBO looks at all of the costs over time, keeping in mind the bulk of the costs are going to be the interest payments that will have to be made over time, we come to a strikingly different conclusion. Instead of 30 percent, CBO calculates it is more like 70 percent, if not higher, depending on interest rates and the extent of monies received by liquidating failed S&L's.

The CHAIRMAN. That is quite a difference, isn't it? You would say 70 percent or higher?

Mr. BLUM. We would say 70 percent or higher.

COST OF INSOLVENT S&L'S RESOLVED TO DATE

The CHAIRMAN. The other portion of the administration's plan deals with paying for the 200 insolvent S&L's that have already been resolved.

Mr. Brady was unable to tell the committee either the 10-year cost or the 30-year cost to the Treasury of this part of the plan. Can you tell us the CBO's estimate of Treasury costs for this part of the plan for 10 years?

Mr. BLUM. Just for the cases that have already been treated, in the figures that he gave to the committee, Mr. Darman looked at the total costs of old cases and other expenses for the full 10-year period of \$52 billion. I am looking at one of the appendix tables that was attached to his testimony.

CBO would calculate that differently; without any interjecting CBO's interest rate assumptions or any other differences, but just rearranging Mr. Darman's numbers, the cash costs to the Treasury would be \$62 billion. Included in the \$52 billion is roughly \$10 billion of notes that were issued in 1989, plus some others, that will

come due during this period of time. The Treasury will have to pay cash to redeem these notes, adding \$10 billion to cash outlays.

This was shown in Mr. Darman's table, but below the line. By rearranging his figures, the cash outflow appears to be \$10 billion higher.

The CHAIRMAN. Then are you saying that the CBO's estimate of the Treasury costs for that part of the plan over a 10-year period would be \$10 billion?

Mr. BLUM. The actual cash outflow would be \$10 billion higher, because we are paying off notes that have been issued since 1986 that have been recorded on the budget as outlays.

The accounting convention has been to record an outlay for notes that have been issued by FSLIC to insolvent banks. As part of the resolution cost, no cash actually went out; it was just a note, but we recorded it as an outlay. We are going to have to pay those notes off over the next 10 years. That is going to cost us, according to the administration's estimates, \$20 billion.

Mr. Darman, in coming to his \$52 billion figure, included only \$10 billion of that \$20 billion cash outflow. That is where CBO gets the extra \$10 billion.

The CHAIRMAN. What about the 30-year costs to the Treasury for this part of the plan?

Mr. BLUM. Well, this part of the plan would not actually entail costs, I think beyond 1999, because the cash outflow would already have occurred. It is paying off these notes within this period that accomplishes that; there would not be any additional costs beyond 1999, unless some of those resolved S&L's become insolvent again.

The CHAIRMAN. Perhaps Mr. Brady ought to know that. When I asked him what the cost over 10 years would be, he didn't have the information, and when I asked him what the cost would be over 30 years, because I was using the parallel approach to the other facet of the program, I assumed that there would be a 33-year cost, and apparently, he did, too, because he didn't tell us, the committee, what you are telling us.

You are telling us that these are 10-year bonds and presumably, that will be the end of it.

Mr. BLUM. That is correct.

The CHAIRMAN. He might be happy to hear that good news. This President's plan calls for the creation of an off-budget agency. We talked about that.

INTEREST PREMIUM ON REFCORP BONDS

Secretary Brady indicated that the interest premium of REFCORP bonds would result in \$125 million a year higher interest costs than Treasury bonds would cost, which would be \$1.2 billion over 10 years and then, I believe, about \$3.8 billion over the 33-year period.

What do you have to say with respect to that? Is that figure accurate or would you differ with that, the \$3.8 billion?

Dr. REISCHAUER. CBO believes the premium is likely to be higher than the approximate 25 basis points that the Secretary was talking about. It is more likely to be 30 to 40 basis points. Thirty basis points, for example, on a \$50 billion borrowing means additional in-

terest costs of \$150 million a year. If it were 40 basis points, then there would be an additional \$200 million a year.

You can multiply those figures by 30 to get the sum total over that period of time. If it is \$150 billion times 30, I get \$4.5 billion. If it is \$200 million in additional interest costs each year, then over a 30-year period, that would sum to \$6 billion.

The CHAIRMAN. Do you feel that a good case can be made to exclude the deficit consequences of Treasury borrowing from Gramm-Rudman targets?

Dr. REISCHAUER. Yes. CBO would argue that very much like the asset sales, the REFCORP activities should not have a significant effect on the macroeconomic situation in the country.

Mr. BLUM. I might point out, Mr. Chairman, that there was an excellent piece in the Wall Street Journal last week by Dr. Martin Feldstein of Harvard University that went into this discussion at some length that you may wish to have as part of the record.

There was also an excellent study that the Congressional Research Service put out in January of this year that addresses exactly the same point and reached exactly the same conclusion.

The CHAIRMAN. The taxpayer is going to have to pay this interest either way, isn't he?

Mr. BLUM. Yes, no question about that.

The CHAIRMAN. Yes.

Mr. BLUM. In terms of the cost over the next 30 years, yes.

The CHAIRMAN. Yes. So having the principal off budget, that would increase the cost to the taxpayers over that period as I understand your figures?

Mr. BLUM. That is correct.

Dr. REISCHAUER. That is correct.

The CHAIRMAN. Of perhaps even up to \$6 billion depending upon the number of basis points?

Mr. BLUM. That is correct.

Dr. REISCHAUER. Right.

The CHAIRMAN. The administration is calculating 25 basis points, and CBO figures it will probably be above that. Twenty-five basis points, what is that, one-fourth of 1 percent?

Dr. REISCHAUER. Correct.

The CHAIRMAN. You are saying it could be four-tenths of 1 percent, two-fifths of 1 percent. So if these bonds were to be sold by the Treasury, there would be that much saving to the taxpayers over a period of 33 years.

Dr. REISCHAUER. Right.

The CHAIRMAN. The administration figures \$3.8 billion, which they don't apparently concede that that would constitute a savings to the taxpayers if the Treasury proceeded directly with the sale of the bonds. But it is true, then, that if the Treasury directed the sale of bonds by the Treasury, taxpayers would save somewhere between \$3.8 billion and \$6 billion over that period of time.

Dr. REISCHAUER. Right.

The CHAIRMAN. Is that accurate?

Mr. BLUM. Yes.

Dr. REISCHAUER. Yes.

PUTTING REFCORP ON-BUDGET TO SAVE INTEREST PAYMENTS

The CHAIRMAN. Well, it would seem to me that we ought to be upfront with the American taxpayers and proceed in a different way from that which the administration proceeds, let the taxpayers know what this is going to cost, because this administration approach is going to end up costing the taxpayers several billion dollars by having it off budget, and you are saying we ought to put it on budget but not count it against the Gramm-Rudman target because it is a nonrecurring item, unlike the other items that annually come along.

If it were not counted against Gramm-Rudman, we would be realizing a saving to the taxpayers over that long period of time of \$3.8 billion, using their figures, to perhaps as much as \$6 billion using your range of estimates.

Dr. REISCHAUER. Correct.

The CHAIRMAN. Right?

Dr. REISCHAUER. Right.

The CHAIRMAN. I agree. That sounds to me like that ought to be handled by Treasury, bond sales, and let the taxpayers have the advantage of that lower interest rate over that long period.

Senator Kerrey, do you have any further questions?

Senator KERREY. No, I do not.

SUBMITTED QUESTIONS

The CHAIRMAN. Dr. Reischauer, thank you very much. There may be additional questions submitted by members of the committee. Senator Hatfield, who could not be here this morning, may have an opening statement. He may also have some questions. I also thank you, Mr. Blum, and the others of your associates who have come before the committee. Thank you very much.

[The following questions were not asked at the hearing, but were submitted to the Office for response subsequent to the hearing:]

QUESTIONS SUBMITTED BY SENATOR BYRD

FSLIC

Question. Please provide for the record an analysis of the effects of direct Treasury borrowing on the deficit, assuming the enactment of all other aspects of the Bush proposal.

Answer. CBO understands that this question applies to the Bush Administration proposal to recapitalize the Federal savings and loan insurance system. The following table shows the CBO estimate of the impact on the budget of direct Treasury borrowing, compared with Resolution Funding Corporation (REFCORP) borrowing. The estimate assumes that REFCORP bonds would have a 40 basis point spread over comparable Treasury financing in 1989, a 35 basis point spread in 1990, and a 30 basis point spread in 1991. The amounts borrowed in each year—\$10 billion in 1989, \$25 billion in 1990, and \$15 billion in 1991—are the Administration's projections. The cumulative decrease in the Federal deficit resulting from Treasury borrowing rather than REFCORP borrowing is estimated to be \$5.2 billion over the next 33 years.

CBO ESTIMATE OF THE BUDGETARY IMPACT OF TREASURY BORROWING COMPARED WITH REFCORP BORROWING

[By fiscal year, in billions of dollars]

	1989	1990	1991	1992	1989-94	1989-99	1989-2022
Treasury Payments for Bond Interest:							
Treasury borrowing		0.4	1.5	2.0	8.7	26.3	120.5
REFCORP borrowing		.4	1.6	2.1	9.3	27.8	125.7
Difference (—) means reduction in the deficit		(¹)	—1	—2	—7	—1.5	—5.2

¹ Less than \$50 million.

Source: Congressional Budget Office.

Note: Details may not add to totals because of rounding.

QUESTIONS SUBMITTED BY SENATOR BURDICK

FARM CREDIT SYSTEM

Question. Has CBO changed the scoring of the FCS Financial Assistance Corporation (FAC) from off budget to on-budget?

How does CBO score it?

What is the reason for the change?

Did CBO's position change because of OMB's position?

Why is CBO's estimate of FAC's cost different from OMB's?

Answer. Spending by the Financial Assistance Corporation (FAC) is not included in budget totals for fiscal year 1989; under current law, however, the budget will include such spending beginning in fiscal year 1990. This change reflects Section 646 of the 1989 Agriculture Appropriations Act (Public Law 100-460), which changes the timing and the amounts paid by FCS institutions for stock in the FAC.

The CBO baseline treats the Financial Assistance Corporation as an on-budget entity beginning in fiscal year 1990. This treatment is consistent with the Administration's decision to place the FAC on the budget when the above-mentioned provision takes effect. CBO stated in a letter to Senator Bumpers dated September 9, 1988, that the proposed change in stock purchases in the FAC should not affect its off-budget status. Because CBO believes that the budgetary treatment of the FAC is a close call, however, that same letter noted that CBO would recognize a change in the budgetary treatment of the FAC if and when such a change were included in the President's 1990 budget. CBO has, therefore, adopted the change shown in the President's 1990 budget submission, which places the FAC on the budget beginning in fiscal year 1990.

CBO's estimate of FAC spending for Farm Credit System assistance is \$600 million in fiscal year 1989, while OMB's estimate is \$1 billion. The estimates differ because CBO projects different needs in each year for financial assistance to Farm Credit System banks under the terms of the Agricultural Credit Act of 1987. The FAC can issue up to \$4 billion in debt to assist FCS institutions. OMB estimates that the FAC will issue \$2.8 billion of the \$4 billion limit, and that most of the assistance will occur during fiscal years 1989 and 1990. CBO estimates that the assistance will ultimately total about \$2.9 billion, but that FAC debt issued to provide this assistance will be spread out over the 1989-93 period. As a result, CBO's estimates of FAC spending are lower than OMB's for years 1989 and 1990, but higher than OMB's for 1991 through 1993.

Question. Will CBO use the CBO baseline as its base for scoring agriculture credit programs?

Answer. Although discussions are currently under way to revise the scoring of certain revolving Farmers Home Administration (FmHA) loan programs, CBO will continue to score credit programs as it has in past years, until any changes are officially adopted.

CBO currently scores appropriation action on FmHA credit programs based on the budget resolution. In recent years, the budget resolution has allocated budget authority and outlays reflecting baseline loan levels to the authorizing committees, while the budgetary impact of any assumed differences from baseline loan levels has been assigned to the Appropriations Committees. Under this procedure, if an appropriation bill sets loan levels identical to those in the baseline, budget authority

and outlays are not affected. If an appropriation bill establishes loan levels different from those in the CBO baseline, the corresponding changes in budget authority and outlays are scored to the Appropriations Committee.

QUESTIONS SUBMITTED BY SENATOR HATFIELD

LOG EXPORTS BAN

Question. One of the new policy initiatives set forth in the Administration's FY 1990 budget proposal would lift the current restriction on the export of unprocessed logs harvested from Federal forest lands. The budget assumes that this policy will result in increased revenues to the Federal treasury of between \$74 million and \$100 million per year.

It is my understanding that CBO has done its own analysis of the impact this proposal will have on Federal revenues and that it shows revenues will increase by only about \$7 million per year. Is this correct?

Could you please provide me with the assumptions you used in your analysis and the analysis itself?

If your study shows only a \$7 million increase, why does it differ so dramatically from OMB's?

Does your analysis project the impact that the proposal would have on employment in the Pacific Northwest and on stumpage prices of Federal timber?

Answer. The Administration proposes to lift the ban on exporting unprocessed logs harvested from Federal lands in the western United States. It estimates that lifting the ban would result in additional receipts to the Federal Government totaling \$100 million in 1990 and \$800 million over the 1990-94 period.

CBO estimates that lifting the ban would have a smaller and more gradual effect on Federal timber receipts, and that additional receipts would total about \$7 million in 1990, \$20 million in 1991, and \$40 million to \$80 million a year thereafter. Over the 1990-94 period, CBO's estimate of receipts from lifting the ban is about \$600 million below the Administration's projection.

The impact on Federal receipts that would result from lifting the log export ban is very uncertain and depends on a number of factors that are very difficult to predict. Among the questions that need to be answered are: 1) how much timber would be affected; 2) what would be the magnitude of the price increase for newly exportable federal timber; 3) which Federal timber contracts would be affected; and 4) how would harvest patterns change?

Volume of timber affected.—The Administration's estimate assumes that approximately 500 million board feet of unprocessed timber is of high enough quality each year to interest timber exporters (primarily to Asia). These exporters are currently restricted to buying only state-grown and private timber, which is generally regarded as inferior to Federal timber. CBO believes that the Administration's estimate of how much timber is of export quality is reasonable.

Impact on Federal stumpage prices.—OMB assumed that exportable Federal timber would capture a premium (additional stumpage price) of \$200 per thousand board feet. It assumed that high quality Federal timber in the Northwest captures an average price of \$400 per thousand board feet under current conditions and that exportability would add a 50 percent (\$200) premium to that price.

CBO used a significantly lower export premium, ranging from 10 percent to 40 percent above current stumpage rates. CBO assumed that Federal stumpage rates would rise, but that export prices would fall from current rates if Federal timber is offered for export, because of the sudden increase in the supply of timber available for export. The effect of these offsetting changes would be a new, lower export price. Estimating the new equilibrium price is difficult; however, CBO estimates that exportable Federal timber would capture a premium of at most \$60 to \$120 per thousand board feet. (The Congressional Research Service has indicated that "it seems likely that the increase in Federal timber prices will be no more than that estimated by CBO, and quite possibly less.")¹

Contracts affected.—The Administration assumes that timber already purchased at high prices in the early 1980s but left uncut when prices later fell, would be allowed to be sold for export if the ban is lifted. Because it assumes that owners of such timber otherwise would be forced to default on their contracts, the Administration projects that lifting the ban would increase receipts by \$100 million in 1990.

¹ Memorandum by Ross W. Gorte, March 6, 1989.

Because all existing contracts prohibit the exportation of the timber, and because each year's ban has only applied to future sales, CBO believes that lifting the ban would affect only new timber sales (those made after Fiscal year 1989) and not existing contracts. Receipts from new sales generally flow into the Federal Treasury over 2 to 5 years, with very little—usually only a minimal down payment—accruing in the first year. CBO's estimate of the increase in receipts in 1990 is therefore minimal (\$7 million).

The Administration further argues that even if timber from these existing contracts cannot be exported, lifting the ban could increase the average price of all timber in the Pacific Northwest whether it is exported or not, thereby making these high-priced existing contracts less likely to default and increasing Federal receipts. CBO believes that under current law defaults on these existing contracts will not be significant, particularly in light of recent Forest Service rules allowing special payment arrangements. In addition, while lifting the ban could have the effect of increasing overall stumpage prices for Federal timber, any overall increase is unlikely to be large enough to significantly increase Federal receipts from existing contracts over the next few years.

Effect of lifting the ban on short-term harvest schedules.—OMB assumed that lifting the ban would result in a dramatic increase in the harvesting of Federal timber, thereby speeding up the receipt of funds by the Federal Government.

CBO believes that harvesting could occur more quickly when the ban is lifted, but because most areas of new timber sales have few roads, harvesting could not be speeded up enough to affect significantly the flow of receipts to the Treasury over the next 2 to 3 years.

Employment effects.—CBO has not prepared an analysis of the effect on employment and on the Northwest economy of lifting the log export ban.

CONCLUSION OF HEARINGS

The CHAIRMAN. That concludes the hearings. The committee will recess and reconvene at the call of the Chair.

[Whereupon, at 11:58 a.m. Thursday, March 9, the hearings were concluded, and the committee was recessed to reconvene subject to the call of the Chair.]

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